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Managing Risk

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Forward-looking statements

This presentation and subsequent discussion may contain certain forward-looking statements with respect to the financial condition, results of operations and business of the Group. These forward-looking statements represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Additional detailed information concerning important factors that could cause actual results to differ materially is available in our Interim Report. Past performance cannot be relied on as a guide to future performance.

All financial information used in this presentation is reported in accordance with HKFRS and extracted from The Hongkong and Shanghai Banking Corporation Limited 2009 Interim Results unless indicated otherwise. 'Hong Kong' includes Hang Seng Bank, 'Asia' includes Hong Kong and Rest of Asia and 'Asia-Pacific' includes Asia and the Middle East, unless stated otherwise.

Agenda

Risk management

Asia risk profile

Risk appetite

Key elements of risk at HSBC: Wholesale and market risk

Key elements of risk at HSBC: Retail credit risk

Summary

Risk management

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Risk management

Risks we face in Asia

- **Risk appetite**
- **Operational risk**
- **Wholesale and market risk**
- **Reputational risk**
- **Retail credit risk**
- **Sustainability risk**

Risk management

Philosophy

- **A conservative risk and capital culture embedded in HSBC values**
- **Low advance-to-deposit ratio (46% as at 30 Jun 09) and high capital reserves (capital adequacy ratio of 15.9% as at 30 Jun 09)**
- **Directed by global policy, regional and country level limits of authority**
- **Predominantly a relationship-led business with a limited proprietary book**
- **Long-term commitment to region and to our customers**

Risk management

Governance

HSBC Asia risk appetite is set by HSBC management board in Asia, within the framework established by HSBC Holdings

The Board delegates authorities to the regional Chief Executive Officer, Chief Risk Officer (CRO) and senior executives

HSBC Holdings plc board → **Asia Management Board** → **Regional Risk Management Committee** → **Country Risk Management Committee**

Risk management

Execution: risk managed independently of the business

- **Global Risk Management Board provides strategic direction and guidance**
- **Functional Risk teams at regional and country levels**
- **Consistent approach across regions and businesses**
- **Primary responsibility lies at legal entity level and managed by CRO**

Chief Risk Officer, Asia-Pacific

- Wholesale risk
- Traded risk (Treasury)
- Retail risk
- Risk strategy
- Operational risk
- Associates and subsidiaries
- Country CROs

Risk management

Policy, Reporting, Systems and People

- **Group Risk policies are integrated into functional, geographic and business policies**
- **Portfolio risk actively managed**
- **Ongoing regular and exception reporting**
- **Continued investment in Group Risk IT systems and processes**
- **Recruitment, development and retention of risk professionals**

Asia risk profile

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Risk profile

Managing balance sheet risk

Total assets, US$bn[1]

Note:
(1) The Hongkong and Shanghai Banking Corporation Limited 2008 Annual Results exclude assets in Malaysia; 2009 Interim Results include Malaysia

Risk appetite

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Risk appetite

Risk appetite framework is a critical building block

- **Framework approved by HSBC Holdings plc board and Asia Management Board**
- **Expresses the types and quantum of risk HSBC wishes to be exposed to, based on HSBC core values, strategy, and risk management competencies**
- **Considers HSBC's risk capacity, financial position, strength of core earnings and resilience of reputation and brand**
- **Expressed in qualitative and quantitative terms**

Risk appetite

Process: risk capital and performance are planned and monitored in an integrated manner

Customer groups

Gross advances
Asset growth projections

Planning function

Return on equity
Other risk appetite metrics: economic capital, profit before tax (PBT), economic profit

Risk function

Risk-weighted assets[1]
Asset growth (EAD)[1]
Credit quality projections (PD)[1]
Recoveries (LGD)[1]

Other risk requirements
Economic capital
(including diversification)

Operational risk

Finance function

Capital supply
Available capital

Note:
(1) Exposure at default (EAD), probability of default (PD), loss given default (LGD)

Risk appetite

Economic capital provides a common currency for assessing risk and capital

- **Supports the evaluation of risks in a consistent manner**
- **Risk-sensitive measure which considers the diversification of HSBC's activities**
- **Capital requirement calculated to support the risks to which HSBC is exposed**
- **Economic capital embodied within the HSBC Capital Management Principles**
- **Economic capital monitored on an ongoing basis by Asia management board**

Risk appetite

Stress testing: risk profile assessed under stress scenarios

- **Stress testing undertaken to understand the sensitivities of capital and business plans to extreme events**
- **Key output: establish management action plans to proactively mitigate risks**
- **Stress testing framework overseen by Asia Management Board**
- **Analysis reviewed and challenged on an ongoing basis, eg by the region's audit committees**
- **Stress tests include macroeconomic and event-driven scenarios**

Key elements of risk at HSBC: Wholesale and market risk

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Wholesale risk

HSBC in Asia wholesale credit portfolio

Product mix of wholesale loans and advances, 30 Jun 09

Wholesale risk

Improving trend in loan impairment charges

Loan impairment charges and other credit risk provisions, US$m

- Impairment charges remain broadly in line with expectations; steady results achieved by Recovery units
- Corporate fraud has been the main enemy in Asia
- Intensified training of relationship managers to identify early warning signals since 2H08

Wholesale risk

Management process for credit risk

Approval on a client-by-client basis	• **Due diligence and credit assessment undertaken for each client** • **All clients have a relationship manager**
Single approval authority structure	• **No credit committees; rather a hierarchy of individual approval authorities**
Corporate counterparty exposures	• **Approval by local operating companies, according to delegated local authorities** • **Subject to local regulator-led large-exposure/ single borrower limits** • **Exposure above local authorities require concurrence at Group level**
Banks, sovereigns and non-bank financial institutions' counterparty exposure	• **Centrally approved after recommendation by local operating companies**

Wholesale risk

Areas of special interest

Leveraged financing	• **Relatively small, good quality book**
Commercial real estate	• **20% of wholesale loans and advances to customers** • **Loan-to-value ratios relatively low**
Automotive sector	• **No significant direct exposure to failed US auto manufacturers; portfolio cap on industry**
Shipping and aviation	• **Longstanding relationships; tight monitoring of facilities**

Wholesale risk

Actions taken in response to market conditions

- **'Watch and worry' list procedures enhanced**
- **Crisis management procedures renewed and strengthened**
- **Enhanced settlement control procedures**
- **Improvement to management information**
- **Reinforcement of conservative credit risk culture**

Market risk

Market risk arises as a result of:

Non-trading business	• **Mismatches between funding cost and yield on assets as a result of interest rate changes**
Trading Business	• **Customer-related business** • **Market-making** • **Proprietary position-taking**

Market risk

Monitoring and limiting exposures

A single measure is not sufficient

HSBC Asia total VaR exposure (Jun 07 to Jun 09), US$m

Positions	USD values
Sensitivities	Non-subjective measures
VaR	Statistical modeling measure
Stress testing	Scenario measure

US$m, 99% confidence level, 1 day holding period

Market risk

How we manage market risk

Group risk appetite is cascaded to regions and countries

- **Risk limit structures are set in terms of sensitivity and VaR**
- **Exposures are monitored against prescribed limits on a daily basis**

New products are approved through a due diligence process

Monthly Business Control Committees are held by line of business

Key elements of risk at HSBC: Retail credit risk

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Retail risk

HSBC in Asia retail credit portfolio: loans and advances

Product mix of retail loans and advances, US$bn[1]

Mortgage advances in Australia grew by US$1.0bn (28%) in 1H09[2]

Mortgage advances in Hong Kong grew by US$0.8bn (3%) in 1H09

Mortgage advances in Singapore grew by US$0.4bn (9%) in 1H09[2]

Notes:
(1) Malaysia included in the accounts of The Hongkong and Shanghai Banking Corporation Limited from Jun 09 onwards; Dec 08 figures shown with Malaysia included here for comparison
(2) Reported in accordance with IFRS in the Group Interim Results

Retail risk

Retail portfolio continues to grow and credit quality remains resilient

Retail advances and impairment charges ratio

Impairment charges rose faster than growth in advances in 1H09

Secured portfolios remain robust with low loan-to-value ratios

Unsecured portfolios under some stress, as the economic downturn has impacted customers' ability to repay, but is manageable

Note:
(1) Impairment charges ratio as a percentage of period-end retail advances (annualised for 1H09); 1H09 includes Malaysia

Retail risk

Governance framework enables us to focus on growing sustainable customer relationships, managing risk and sharing best practices

Regular reporting to Group Management Board, Asia Management Board, Group Risk, Regional Audit Committee, Regional Risk Management Committee and Country Risk Management Committees

Concentration, growth rates, delinquency, risk-weighted assets and write-offs are regularly monitored against plan

Caps and triggers processes in place to highlight areas of concern and prevent build-up of risk, eg concentration risk, excessive growth rates

Group Risk provides oversight; Regional Risk drives strategy development and Country Risk executes strategy

Retail risk

Actively supporting the development and deployment of One HSBC to join-up products, processes and systems

Global analytics

Collections

Account opening

Retail risk

Personal lending challenges and actions taken

Themes	HSBC actions
Economic downturn and rising unemployment	• Proactive account management actions • Review collections strategies
Focus on sustainable customer relationship and strategic growth	• Tighten lending policies • Review collections strategies • Exit from higher risk segments
Supporting customers through difficult times	• Debt work-out and restructuring options offered where appropriate

Operational risk

Integrated Operational Risk and Internal Control functions provide effective secondary level oversight of the business

Strong operational risk and control culture embedded in the business

Consistent governance approach in place across the region

Regular reporting to Group Management Board, Asia Management Board, Group Risk, Regional Audit Committee, Regional Risk Management Committee and Country Risk Management Committees

Framework and methodology being enhanced, with increased focus on top-down, forward-looking risk management and monitoring

Reputational risk

We are proud of HSBC's strong global reputation

- **Committee framework established**
- **Transaction and products covered in Global Banking and Markets**
- **Strategy covered by Regional Risk Management Committee**

Sustainability risk

Global approach to sustainability risk

- **Original signatory to the Equator Principles**
- **Policies are currently in place for forestry, energy, freshwater, chemicals, metals and mining sectors**
- **Key concerns in emerging markets, sustainability risk requires continual close monitoring**
- **Sustainability risk managers are appointed in all key sites**
- **Sustainability risk managers' responsibilities range from discussing individual transactions to policy implementation**

Summary

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Summary

Strong through the downturn: well positioned for the upturn

- **Capital and deposits**
- **Longer-term outlook: leadership and customers**
- **Strong risk-aware culture**
- **Relationship-driven approach to banking**
- **Global, regional, country transfer of knowledge and expertise**