



The Hongkong and Shanghai Banking  
Corporation Limited

**Interim Disclosure Statement**  
*prepared under the Banking (Disclosure) Rules  
made pursuant to section 60A of the Banking Ordinance*

**Supplementary Notes**  
for the six months ended 30 June 2012

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The information contained in this document is for The Hongkong and Shanghai Banking Corporation Limited ('the Bank') and its subsidiaries (together 'the group'). It is supplementary to, and should be read in conjunction with, the 2012 Interim Consolidated Results Press Release issued on 30 July 2012, available at [www.hsbc.com.hk](http://www.hsbc.com.hk). The information in the two documents, taken together, complies with the Banking (Disclosure) Rules made under section 60A of the Banking Ordinance.

## 1. Basis of preparation

a. The group uses the advanced internal ratings-based approach to calculate its credit risk for the majority of its non-securitisation exposures and the internal ratings-based (securitisation) approach to determine credit risk for its securitisation exposures. For market risk, the group uses an internal models approach to calculate its general market risk and market risk relating to equity options. The group uses an internal models approach to calculate its market risk in respect of specific risk for the interest rate risk category. The group uses the standardised (market risk) approach for calculating other market risk positions and the standardised (operational risk) approach to calculate its operational risk. There are no changes in the approaches used in 2012.

b. Except where indicated otherwise, the financial information contained in these Supplementary Notes has been prepared on a consolidated basis. The basis of consolidation for regulatory purposes is different from that for accounting purposes. Further information regarding subsidiaries that are not included in the consolidation for regulatory purposes is set out in Supplementary Note 25.

c. The accounting policies applied in preparing these Supplementary Notes are the same as those applied in preparing the consolidated financial statements for the year ended 31 December 2011, as set out in note 3 on the financial statements in the Annual Report and Accounts.

## 2. Net interest income

	<b>Half-year ended 30 June 2012 HK\$m</b>	Half-year ended 30 June 2011 HK\$m
Net interest income includes the following:		
- interest income accrued on impaired financial assets	<b>101</b>	183

**3. Net fee income**

	<b>Half-year ended 30 June 2012 HK\$m</b>	Half-year ended 30 June 2011 HK\$m
Net fee income includes the following:		
Net fee income, other than amounts included in determining the effective interest rate, arising from financial assets or financial liabilities that are not held for trading or designated at fair value		
- fee income	7,660	7,468
- fee expense	<u>(771)</u>	<u>(664)</u>
	<b><u>6,889</u></b>	<b><u>6,804</u></b>
Net fee income arising from trust and other fiduciary activities where the group holds or invests assets on behalf of its customers		
- fee income	4,426	4,928
- fee expense	<u>(560)</u>	<u>(642)</u>
	<b><u>3,866</u></b>	<b><u>4,286</u></b>

**4. Gains less losses on loans and receivables, held-to-maturity investments and financial liabilities measured at amortised cost**

	<b>Half-year ended 30 June 2012 HK\$m</b>	Half-year ended 30 June 2011 HK\$m
Loans and receivables	<u>363</u>	<u>373</u>

There are no gains or losses on held-to-maturity investments or financial liabilities measured at amortised cost for the half-year ended 30 June 2012 and 30 June 2011.

**5. Dividend income**

	<b>Half-year ended 30 June 2012 HK\$m</b>	Half-year ended 30 June 2011 HK\$m
Listed investments	205	313
Unlisted investments	<u>149</u>	<u>232</u>
	<b><u>354</u></b>	<b><u>545</u></b>

**6. Cash and short-term funds**

	At <b>30 June 2012</b> <b>HK\$m</b>	At 31 December 2011 HK\$m
Cash in hand	<b>18,928</b>	15,204
Sight balances with central banks	<b>103,210</b>	94,903
Placing with banks with remaining maturity of one month or less	<b>370,096</b>	456,294
Treasury bills and other eligible bills	<b>428,560</b>	353,505
	<b><u>920,794</u></b>	<u>919,906</u>

As at 30 June 2012, included within notes 6 and 7, the total amount placed with central banks, including sight balances, amounted to HK\$311,260m (31 December 2011: HK\$350,823m).

**7. Placings with banks maturing after one month**

	At <b>30 June 2012</b> <b>HK\$m</b>	At 31 December 2011 HK\$m
Gross placings with banks maturing after one month but not more than one year	<b>226,597</b>	173,498
Gross placings with banks maturing after one year	<b>36,311</b>	24,789
Total placings with banks maturing after one month	<b><u>262,908</u></b>	<u>198,287</u>

There are no significant overdue, impaired or rescheduled placings with banks as at 30 June 2012 and 31 December 2011.

**8. Certificates of deposit**

	At <b>30 June 2012</b> <b>HK\$m</b>	At 31 December 2011 HK\$m
Held-to-maturity	<b>9,418</b>	8,342
Available-for-sale	<b>84,436</b>	80,349
	<b><u>93,854</u></b>	<u>88,691</u>

## 9. Loans and advances to customers

### a. Analysis of loans and advances to customers by industry sector based on categories and definitions used by the Hong Kong Monetary Authority ('HKMA')

The following analysis of the group's loans and advances to customers is based on the categories contained in the 'Quarterly Analysis of Loans and Advances and Provisions' return required to be submitted to the HKMA by branches of the Bank and by banking subsidiary companies in Hong Kong.

	Gross Advances		Collateral and other security	
	At 30 June 2012 HK\$m	At 31 December 2011 HK\$m	At 30 June 2012 HK\$m	At 31 December 2011 HK\$m
<i>Industrial, commercial and financial</i>				
Property development	67,640	71,309	24,286	23,200
Property investment	199,700	200,721	156,336	155,130
Financial concerns	14,058	11,852	2,959	1,804
Stockbrokers	1,806	3,117	314	331
Wholesale and retail trade	85,730	75,379	20,917	19,352
Manufacturing	30,983	31,897	6,278	6,313
Transport and transport equipment	26,373	27,429	19,136	18,948
Recreational activities	471	88	84	17
Information technology	5,962	4,888	779	34
Others	61,377	58,775	20,716	18,508
	<b>494,100</b>	<b>485,455</b>	<b>251,805</b>	<b>243,637</b>
<i>Individuals</i>				
Advances for the purchase of flats under the Hong Kong Government's Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	24,767	25,640	24,737	25,558
Advances for the purchase of other residential properties	313,796	298,560	313,794	298,277
Credit card advances	40,116	41,200	–	–
Others	38,850	40,036	10,644	11,250
	<b>417,529</b>	<b>405,436</b>	<b>349,175</b>	<b>335,085</b>
Gross loans and advances to customers for use in Hong Kong	911,629	890,891	600,980	578,722
Trade finance	158,801	142,253	27,537	31,113
Gross loans and advances to customers for use outside Hong Kong	1,162,709	1,109,028	410,348	393,748
Gross loans and advances to customers	<b>2,233,139</b>	<b>2,142,172</b>	<b>1,038,865</b>	<b>1,003,583</b>

**9. Loans and advances to customers (continued)****b. Impairment allowances on loans and advances to customers**

The geographical information shown below has been classified by the location of the principal operations of the subsidiary or, in the case of the Bank, by the location of the branch responsible for advancing the funds.

	Hong Kong HK\$m	Rest of Asia-Pacific HK\$m	Total HK\$m
<b>At 30 June 2012</b>			
<b>Gross loans and advances to customers</b>			
Individually assessed impaired gross loans and advances	3,535	9,116	12,651
Collectively assessed	1,233,855	986,633	2,220,488
Impaired loans and advances	617	879	1,496
Non-impaired loans and advances	1,233,238	985,754	2,218,992
Total gross loans and advances to customers	<u>1,237,390</u>	<u>995,749</u>	<u>2,233,139</u>
<b>Impairment allowances</b>	<b>(4,061)</b>	<b>(7,457)</b>	<b>(11,518)</b>
Individually assessed	(1,870)	(5,267)	(7,137)
Collectively assessed	(2,191)	(2,190)	(4,381)
Net loans and advances	<u>1,233,329</u>	<u>988,292</u>	<u>2,221,621</u>
Fair value of collateral which has been taken into account in respect of individually assessed impaired loan and advances to customers	1,449	3,389	4,838
Individually assessed impaired gross loans and advances as a percentage of gross loans and advances to customers	0.3%	0.9%	0.6%
Total allowances as a percentage of total gross loans and advances	0.3%	0.7%	0.5%
<b>At 31 December 2011</b>			
<b>Gross loans and advances to customers</b>			
Individually assessed impaired gross loans and advances	3,881	8,490	12,371
Collectively assessed	1,182,989	946,812	2,129,801
Impaired loans and advances	657	823	1,480
Non-impaired loans and advances	1,182,332	945,989	2,128,321
Total gross loans and advances to customers	<u>1,186,870</u>	<u>955,302</u>	<u>2,142,172</u>
<b>Impairment allowances</b>	<b>(4,428)</b>	<b>(6,873)</b>	<b>(11,301)</b>
Individually assessed	(2,174)	(4,720)	(6,894)
Collectively assessed	(2,254)	(2,153)	(4,407)
Net loans and advances	<u>1,182,442</u>	<u>948,429</u>	<u>2,130,871</u>
Fair value of collateral which has been taken into account in respect of individually assessed impaired loan and advances to customers	1,403	3,252	4,655
Individually assessed impaired gross loans and advances as a percentage of gross loans and advances to customers	0.3%	0.9%	0.6%
Total allowances as a percentage of total gross loans and advances	0.4%	0.7%	0.5%

**9. Loans and advances to customers** *(continued)***b. Impairment allowances on loans and advances to customers** *(continued)*

For individually assessed customer loans and advances where the industry sector comprises not less than 10% of total gross loans and advances to customers, the analysis of gross impaired loans and advances and allowances by major industry sectors based on categories and definitions used by the HSBC Group is as follows:

	<b>Total gross loans and advances HK\$m</b>	<b>Gross impaired advances HK\$m</b>	<b>Individually assessed allowances HK\$m</b>	<b>Collectively assessed allowances HK\$m</b>
<b>At 30 June 2012</b>				
Residential mortgages	635,437	2,215	(367)	(137)
Commercial, industrial and international trade	703,696	7,102	(5,012)	(1,959)
Commercial real estate	236,830	528	(321)	(96)
Other commercial	227,349	747	(379)	(556)
<b>At 31 December 2011</b>				
Residential mortgages	608,135	2,369	(372)	(166)
Commercial, industrial and international trade	661,308	6,970	(5,184)	(2,049)
Commercial real estate	232,263	580	(268)	(69)
Other commercial	213,603	800	(401)	(549)

Collectively assessed allowances refer to impairment allowances which are assessed on a collective basis for those individually assessed loans and advances where an individual impairment has not yet been identified.



**9. Loans and advances to customers** (*continued*)**c. Overdue and rescheduled loans and advances to customers**

The geographical information shown below has been classified by the location of the principal operations of the subsidiary or, in the case of the Bank, by the location of the branch responsible for advancing the funds.

	Hong Kong		Rest of Asia-Pacific		Total	
	HK\$m	%	HK\$m	%	HK\$m	%
<b>At 30 June 2012</b>						
Gross amounts which have been overdue with respect to either principal or interest for periods of						
– more than three months but less than six months	332	0.0	1,694	0.2	2,026	0.1
– more than six months but less than one year	639	0.1	2,425	0.2	3,064	0.1
– more than one year	1,706	0.1	3,134	0.3	4,840	0.2
	<b>2,677</b>	<b>0.2</b>	<b>7,253</b>	<b>0.7</b>	<b>9,930</b>	<b>0.4</b>
Individually assessed impairment allowances made in respect of amounts overdue	(1,394)		(4,324)		(5,718)	
Fair value of collateral held in respect of amounts overdue	901		2,083		2,984	
Rescheduled loans and advances to customers	575	0.0	2,088	0.2	2,663	0.1
<b>At 31 December 2011</b>						
Gross amounts which have been overdue with respect to either principal or interest for periods of						
– more than three months but less than six months	616	0.1	3,446	0.4	4,062	0.2
– more than six months but less than one year	234	0.0	720	0.1	954	0.0
– more than one year	1,807	0.2	2,880	0.3	4,687	0.2
	<b>2,657</b>	<b>0.3</b>	<b>7,046</b>	<b>0.8</b>	<b>9,703</b>	<b>0.4</b>
Individually assessed impairment allowances made in respect of amounts overdue	(1,614)		(4,106)		(5,720)	
Fair value of collateral held in respect of amounts overdue	825		2,030		2,855	
Rescheduled loans and advances to customers	1,257	0.1	1,938	0.2	3,195	0.1

**9. Loans and advances to customers** *(continued)***c. Overdue and rescheduled loans and advances to customers** *(continued)*

Rescheduled loans and advances to customers are those loans and advances which have been restructured or renegotiated because of a deterioration in the financial position of the borrower, or because of the inability of the borrower to meet the original repayment schedule. Rescheduled loans and advances to customers are stated net of any loans and advances which have subsequently become overdue for more than three months and which are included in 'Overdue loans and advances to customers'.

**d. Analysis of loans and advances to customers by geographical areas according to the location of counterparties, after recognised risk transfer**

	<b>Hong Kong HK\$m</b>	<b>Rest of Asia-Pacific HK\$m</b>	<b>Total HK\$m</b>
<b>At 30 June 2012</b>			
Gross loans and advances to customers	<u>1,040,548</u>	<u>1,192,591</u>	<u>2,233,139</u>
<b>At 31 December 2011</b>			
Gross loans and advances to customers	<u>1,002,945</u>	<u>1,139,227</u>	<u>2,142,172</u>

**e. Collateral**

The most common method of mitigating credit risk is to take collateral. Collateral disclosed in notes 9a, 9b and 9c includes any tangible security that has a determinable fair market value and is readily marketable. This includes (but is not limited to) cash and deposits, stocks and bonds, mortgages over properties and charges over other fixed assets such as plant and equipment. Where collateral values are greater than gross advances, only the amount of collateral up to the gross advance has been included.

**10. Non-bank Mainland exposures**

The analysis of non-bank mainland exposures is based on the categories of non-bank counterparties and the type of direct exposures defined by the HKMA under the Banking (Disclosure) Rules with reference to the HKMA return for non-bank mainland exposures, which includes the mainland exposures extended by the Bank and its wholly owned banking subsidiaries in mainland China.

	On-balance sheet exposure HK\$m	Off-balance sheet exposure HK\$m	Total exposures HK\$m	Specific provisions HK\$m
<b>At 30 June 2012</b>				
Mainland entities	113,984	11,590	125,574	–
Companies and individuals outside the mainland where the credit is granted for use in the mainland	34,061	3,930	37,991	46
Other counterparties the exposures to whom are considered by the Bank to be non-bank mainland exposures	<u>3,330</u>	<u>2,755</u>	<u>6,085</u>	<u>–</u>
	<b>151,375</b>	<b>18,275</b>	<b>169,650</b>	<b>46</b>
Mainland exposures of wholly owned mainland subsidiaries:				
Loans and advances	141,911	2,892	144,803	45
Debt securities and other	<u>108,469</u>	<u>17,800</u>	<u>126,269</u>	<u>–</u>
	<b>250,380</b>	<b>20,692</b>	<b>271,072</b>	<b>45</b>
	<b>401,755</b>	<b>38,967</b>	<b>440,722</b>	<b>91</b>
<b>At 31 December 2011</b>				
Mainland entities	99,498	11,161	110,659	–
Companies and individuals outside the mainland where the credit is granted for use in the mainland	52,382	7,557	59,939	44
Other counterparties the exposures to whom are considered by the Bank to be non-bank mainland exposures	<u>4,325</u>	<u>1,353</u>	<u>5,678</u>	<u>–</u>
	156,205	20,071	176,276	44
Mainland exposures of wholly owned mainland subsidiaries:				
Loans and advances	129,699	3,739	133,438	50
Debt securities and other	<u>104,469</u>	<u>19,574</u>	<u>124,043</u>	<u>–</u>
	234,168	23,313	257,481	50
	<b>390,373</b>	<b>43,384</b>	<b>433,757</b>	<b>94</b>

## 11. Cross-border exposures

The group's country risk exposures in the table below are prepared in accordance with the HKMA return of External Positions Part II: Cross-Border Claims (MA(BS)9B) guidelines. Cross-border claims are on-balance sheet exposures to counterparties based on the location of the counterparties after taking into account the transfer of risk.

The table shows claims on individual countries and territories or areas, after recognised risk transfer, amounting to not less than 10% of the aggregate cross-border claims. Cross-border risk is controlled centrally through a well-developed system of country limits and is frequently reviewed to avoid concentration of transfer, economic or political risk.

	Banks HK\$m	Public sector entities <sup>1</sup> HK\$m	Others HK\$m	Total HK\$m
<b>As at 30 June 2012</b>				
<b>Asia-Pacific excluding Hong Kong</b>				
China	300,312	15,659	150,977	466,948
Japan	25,277	158,377	20,859	204,513
Others	133,655	82,881	255,359	471,895
	<u>459,244</u>	<u>256,917</u>	<u>427,195</u>	<u>1,143,356</u>
<b>Americas</b>				
United States	29,121	107,191	37,626	173,938
Others	37,278	16,007	92,634	145,919
	<u>66,399</u>	<u>123,198</u>	<u>130,260</u>	<u>319,857</u>
<b>Europe</b>	<u>207,783</u>	<u>40,584</u>	<u>81,710</u>	<u>330,077</u>
<b>As at 31 December 2011</b>				
<b>Asia-Pacific excluding Hong Kong</b>				
China	281,204	59,324	125,582	466,110
Japan	16,318	139,874	12,436	168,628
Others	122,534	66,422	233,141	422,097
	<u>420,056</u>	<u>265,620</u>	<u>371,159</u>	<u>1,056,835</u>
<b>Americas</b>				
United States	52,676	120,498	41,505	214,679
Others	38,203	18,866	88,227	145,296
	<u>90,879</u>	<u>139,364</u>	<u>129,732</u>	<u>359,975</u>
<b>Europe</b>	<u>217,656</u>	<u>58,750</u>	<u>57,528</u>	<u>333,934</u>

<sup>1</sup> Includes balances with central banks

**12. Financial investments**

	<b>At 30 June 2012 HK\$m</b>	At 31 December 2011 HK\$m
Debt securities		
– held-to-maturity	<b>145,840</b>	134,720
– available-for-sale	<b>471,278</b>	542,536
Equity shares		
– available-for-sale	<u><b>48,676</b></u>	<u>45,177</u>
	<u><b>665,794</b></u>	<u>722,433</u>

Included in the above are debt securities of HK\$37m overdue for more than one year (31 December 2011: HK\$16m overdue for more than one year).

**13. Interests in associates**

	<b>At 30 June 2012 HK\$m</b>	At 31 December 2011 HK\$m
Interests in associates	<u><b>109,573</b></u>	<u>90,130</u>

**14. Property, plant and equipment**

	Land and buildings HK\$m	Investment properties HK\$m	Equipment HK\$m	Total HK\$m
<b>Cost or valuation</b>				
At 1 January 2012	75,090	4,616	21,922	101,628
Exchange and other adjustments	(98)	–	(55)	(153)
Additions	89	–	645	734
Disposals	(2)	–	(370)	(372)
Elimination of accumulated depreciation on revalued land and buildings	(865)	–	–	(865)
Surplus on revaluation	2,432	259	–	2,691
Reclassifications	(296)	59	(579)	(816)
At 30 June 2012	<u>76,350</u>	<u>4,934</u>	<u>21,563</u>	<u>102,847</u>
<b>Accumulated depreciation</b>				
At 1 January 2012	21	–	16,313	16,334
Exchange and other adjustments	(3)	–	(43)	(46)
Charge for the period	953	–	1,090	2,043
Disposals	–	–	(338)	(338)
Elimination of accumulated depreciation on revalued land and buildings	(865)	–	–	(865)
Reclassifications	(1)	–	(336)	(337)
At 30 June 2012	<u>105</u>	<u>–</u>	<u>16,686</u>	<u>16,791</u>
<b>Net book value at 30 June 2012</b>	<u>76,245</u>	<u>4,934</u>	<u>4,877</u>	<u>86,056</u>
Net book value at 31 December 2011	<u>75,069</u>	<u>4,616</u>	<u>5,609</u>	<u>85,294</u>

**15. Other assets**

Included in the balance sheet within 'Other assets' are, *inter alia*, repossessed assets which are non-financial assets acquired in exchange for loans in order to achieve an orderly realisation, and are reported at the lower of fair value (less costs to sell) and the carrying amount of the loan (net of any impairment allowance).

	At 30 June 2012 HK\$m	At 31 December 2011 HK\$m
Repossessed assets	<u>180</u>	<u>112</u>

There are no significant overdue other assets as at 30 June 2012 and 31 December 2011.

**16. Trading liabilities**

	At 30 June 2012 HK\$m	At 31 December 2011 HK\$m
Certificates of deposit in issue	3,500	5,790
Other debt securities in issue	16,361	15,738
Short positions in securities	45,680	44,891
Deposits by banks	12,198	6,642
Customer accounts	119,392	98,370
	<u>197,131</u>	<u>171,431</u>

**17. Financial liabilities designated at fair value**

	At 30 June 2012 HK\$m	At 31 December 2011 HK\$m
Deposits by banks	294	302
Customer accounts	1,517	1,618
Debt securities in issue	4,025	3,990
Liabilities to customers under investment contracts	35,335	34,482
	<u>41,171</u>	<u>40,392</u>

**18. Debt securities in issue**

	At 30 June 2012 HK\$m	At 31 December 2011 HK\$m
Certificates of deposit	37,945	37,281
Other debt securities	44,184	40,191
	<u>82,129</u>	<u>77,472</u>

**19. Subordinated liabilities**

Subordinated liabilities consist of undated primary capital notes and other loan capital having an original term to maturity of five years or more, raised by the group for the development and expansion of its business.

		At 30 June 2012 HK\$m	At 31 December 2011 HK\$m
<i>Bank</i>			
US\$1,200m	Undated floating rate primary capital notes	<b>9,366</b>	9,386
<i>Group</i>			
A\$42m	Floating rate subordinated notes due 2018, callable from 2013 <sup>1</sup>	<b>333</b>	332
A\$200m	Floating rate subordinated notes due 2020, callable from 2015	<b>1,587</b>	1,580
US\$300m	Floating rate subordinated notes due 2017, callable from 2012 <sup>2</sup>	<b>2,326</b>	2,328
RM500m	Fixed rate (4.35%) subordinated bonds due 2022, callable from 2017 <sup>3</sup>	<b>1,224</b>	1,227
RM500m	Fixed rate (5.05%) subordinated bonds due 2027, callable from 2022 <sup>4</sup>	<b>1,265</b>	1,261
		<b>16,101</b>	16,114

1 The interest rate on the A\$42m callable subordinated floating rate notes due 2018 will increase by 0.5% from March 2013.

2 The US\$300m callable subordinated floating rate notes due 2017 were redeemed in July 2012.

3 The interest rate on the 4.35% callable subordinated bonds due 2022 will increase by 1% from June 2017.

4 The interest rate on the 5.05% callable subordinated bonds due 2027 will increase by 1% from November 2022.



**20. Off-balance sheet exposures other than derivative transactions**

	At 30 June 2012 HK\$m	At 31 December 2011 HK\$m
<b>Contingent liabilities and commitments</b>		
Direct credit substitutes	60,134	57,975
Transaction-related contingencies	123,448	105,925
Trade-related contingencies	115,174	104,830
Forward asset purchases	2,746	2,870
Forward forward deposits placed	4,868	247
Commitments that are unconditionally cancellable without prior notice	1,232,106	1,173,870
Commitments which have an original maturity of not more than one year	91,644	91,393
Commitments which have an original maturity of more than one year	144,140	133,613
	<u>1,774,260</u>	<u>1,670,723</u>
<b>Risk-weighted amounts</b>	<u>201,320</u>	<u>193,043</u>

The table above gives the nominal contract amounts and risk-weighted amounts of contingent liabilities and commitments. The information is consistent with that in the 'Capital Adequacy Ratio' return submitted to the HKMA by the group. The return is prepared on a consolidated basis as specified by the HKMA under the requirement of section 98(2) of the Banking Ordinance.

For accounting purposes, acceptances and endorsements are recognised on the balance sheet in 'Other assets' in accordance with HKAS 39 'Financial Instruments: Recognition and Measurement'. For the purposes of the Banking (Capital) Rules, acceptances and endorsements are included in the capital adequacy calculation as if they were contingencies.

Contingent liabilities and commitments are mainly credit-related instruments which include non-financial guarantees and commitments to extend credit. Contractual amounts represent the amounts at risk should contracts be fully drawn upon and clients default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contractual amounts is not representative of expected future liquidity requirements.

**21. Derivative transactions****a. Contract amounts of derivative transactions**

	At 30 June 2012 HK\$m	At 31 December 2011 HK\$m
Exchange rate	12,915,254	10,999,759
Interest rate	18,266,268	17,498,507
Credit derivative	405,793	465,174
Equities, commodity and other	1,093,612	873,197
	<u>32,680,927</u>	<u>29,836,637</u>

**21. Derivative transactions** *(continued)***a. Contract amounts of derivative transactions** *(continued)*

The notional contract amounts of derivatives held indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

**b. Risk exposures to derivative transactions**

	<b>Contract amount HK\$m</b>	<b>Risk- weighted amount HK\$m</b>	<b>Fair value HK\$m</b>
<b>At 30 June 2012</b>			
Exchange rate contracts	11,160,867	50,634	47,437
Interest rate contracts	15,401,778	24,849	34,383
Credit derivative contracts	430,945	807	517
Other OTC derivative contracts	428,731	4,377	9,755
	<u>27,422,321</u>	<u>80,667</u>	<u>92,092</u>
<b>At 31 December 2011</b>			
Exchange rate contracts	10,012,732	42,878	49,458
Interest rate contracts	15,343,568	23,250	31,386
Credit derivative contracts	478,815	896	1,279
Other OTC derivative contracts	359,619	3,206	9,185
	<u>26,194,734</u>	<u>70,230</u>	<u>91,308</u>

1 Fair value is calculated after taking into account the effect of valid bilateral netting agreements amounting to HK\$287,745m at 30 June 2012 (31 December 2011: HK\$280,732m).

The table above gives the contract amounts, the risk-weighted amounts and the fair value of derivative exposures. The information is consistent with that in the 'Capital Adequacy Ratio' return submitted to the HKMA. The return is prepared on a consolidated basis as specified by the HKMA under the requirement of section 98(2) of the Banking Ordinance.

Fair value is a close approximation of the credit risk for these contracts at the balance sheet date. The actual credit risk is measured internally as the sum of positive fair values and an estimate for the future fluctuation risk, using a future risk factor.

The netting benefits represent amounts where the group has in place legally enforceable rights of offset with individual counterparties to offset the gross amount of positive mark-to-market assets with any negative mark-to-market liabilities with the same customer. These offsets are recognised by the HKMA in the calculation of risk-weighted amounts for the capital adequacy ratio.

## 22. Foreign exchange exposure

Foreign exchange exposures may be divided broadly into two categories: structural and non-structural. The group's gross structural foreign exchange exposure is represented by the net asset value of the group's foreign currency investments in subsidiaries, branches and associates, and the fair value of the group's long-term foreign currency equity investments. Non-structural exposures arise primarily from trading positions and balance sheet management activities. Non-structural exposures can arise and change rapidly. Foreign currency exposures are managed in accordance with the group's risk management policies and procedures.

The group had the following net structural foreign currency exposures that were not less than 10% of total net structural foreign currency positions:

	<u>Net structural position</u>	
	LCYm	HK\$m
<b>At 30 June 2012</b>		
Chinese renminbi	<b>141,926</b>	<b>174,043</b>
At 31 December 2011		
Chinese renminbi	117,895	145,347

The group had the following non-structural foreign currency positions that were not less than 10% of the net non-structural positions in all foreign currencies:

	United States dollars HK\$m	Singapore dollars HK\$m	Brunei dollars HK\$m
<b>At 30 June 2012</b>			
Spot assets	<b>1,302,835</b>	<b>255,412</b>	<b>19,627</b>
Spot liabilities	<b>(1,467,234)</b>	<b>(232,705)</b>	<b>(23,029)</b>
Forward purchases	<b>6,250,125</b>	<b>472,632</b>	<b>5,498</b>
Forward sales	<b>(6,104,028)</b>	<b>(492,230)</b>	<b>(5,556)</b>
Net options positions	<b>4,139</b>	<b>145</b>	<b>–</b>
	<b><u>(14,163)</u></b>	<b><u>3,254</u></b>	<b><u>(3,460)</u></b>
At 31 December 2011			
Spot assets	1,254,317	325,563	10,508
Spot liabilities	(1,430,476)	(331,008)	(27,893)
Forward purchases	5,816,926	436,756	752
Forward sales	(5,669,458)	(413,455)	(1,467)
Net options positions	9,826	(14)	–
	<b><u>(18,865)</u></b>	<b><u>17,842</u></b>	<b><u>(18,100)</u></b>

The net options positions reported above are calculated using the delta-weighted position of the options contracts.

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**23. Liquidity ratio**

The Banking Ordinance requires banks operating in Hong Kong to maintain a minimum liquidity ratio of 25%, calculated in accordance with the provisions of the Fourth Schedule of the Banking Ordinance. This requirement applies separately to the Hong Kong branches of the Bank and to those subsidiary companies which are authorised institutions under the Banking Ordinance in Hong Kong.

The average liquidity ratios for the period are as follows:

	<b>Half-year ended 30 June 2012 %</b>	<b>Half-year ended 30 June 2011 %</b>
Hong Kong branches of the Bank	<u>37.7</u>	<u>33.3</u>

**24. Capital adequacy**

The capital ratios and risk weighted assets on a consolidated basis, calculated in accordance with the Banking (Capital) Rules, are as follows:

*Capital Ratios*

	At 30 June 2012 %	At 31 December 2011 %
Capital adequacy ratio	14.8	14.6
Core capital ratio	13.3	12.4

*Risk weighted assets*

	At 30 June 2012 HK\$m	At 31 December 2011 HK\$m
Credit risk	1,392,541	1,350,467
Counterparty risk	81,258	71,270
Market risk	95,700	38,585
Operational risk	234,188	221,429
Total	<u>1,803,687</u>	<u>1,681,751</u>

*Deductible items*

	At 30 June 2012 HK\$m	At 31 December 2011 HK\$m
Total of items deductible 50% from core capital and 50% from supplementary capital	<u>126,880</u>	<u>107,778</u>

The Bank and its banking subsidiaries maintain a regulatory reserve to satisfy the provisions of the Banking Ordinance and local regulatory requirements for prudential supervision purposes. At 30 June 2012, the effect of this requirement is to restrict the amount of reserves which can be distributed to shareholders by HK\$17,710m (31 December 2011: HK\$17,108m).

There are no relevant capital shortfalls in any of the group's subsidiaries as at 30 June 2012 which are not included in its consolidation group for regulatory purposes.

The following table shows the components of the capital base, risk weighted assets and capital adequacy ratio as contained in the 'Capital Adequacy Ratio' return required to be submitted to the HKMA by The Hongkong and Shanghai Banking Corporation Limited on a consolidated basis that is specified by the HKMA under the requirements of section 98(2) of the Banking Ordinance.

**24. Capital adequacy (continued)**

	At 30 June 2012 HK\$m	At 31 December 2011 HK\$m
<b>Core capital:</b>		
Share capital per balance sheet	45,404	30,190
Revaluation reserve capitalisation issue	(1,454)	(1,454)
Paid-up ordinary share capital	43,950	28,736
Paid-up irredeemable non-cumulative preference shares	51,602	51,681
Reserves per balance sheet	343,409	310,634
Proposed dividend	(7,500)	(10,000)
Unconsolidated subsidiaries	(36,552)	(32,672)
Cash flow hedging reserve	(2)	(51)
Regulatory reserve	(17,710)	(17,108)
Reserves arising from revaluation of property and unrealised gains on available-for-sale equities and debt securities	(80,437)	(73,570)
Unrealised gains on equities and debt securities designated at fair value	(36)	(77)
Own credit spread	(333)	(429)
Total reserves included in core capital	200,839	176,727
Non-controlling interests per balance sheet	32,606	30,519
Non-controlling interests in unconsolidated subsidiaries	(3,267)	(2,838)
Regulatory adjustments to non-controlling interests	(2,554)	(2,976)
Non-controlling interests	26,785	24,705
Goodwill and intangible assets	(19,228)	(19,663)
50% of unconsolidated investments	(63,286)	(53,749)
50% of securitisation positions and other deductions	(154)	(140)
Deductions	(82,668)	(73,552)
<b>Total core capital</b>	<b>240,508</b>	<b>208,297</b>
<b>Supplementary capital:</b>		
Paid-up irredeemable cumulative preference shares	16,521	16,546
Perpetual subordinated debt	9,366	9,386
Paid-up term preference shares	26,759	28,742
Term subordinated debt	16,317	16,327
Property revaluation reserves <sup>1</sup>	7,977	7,977
Unrealised gains on available-for-sale equities and debt securities <sup>2</sup>	2,395	2,318
Unrealised gains on equities and debt securities designated at fair value	16	35
Regulatory reserve <sup>3</sup>	2,274	2,267
Collective impairment allowances <sup>3</sup>	512	545
Excess impairment allowances over expected losses <sup>4</sup>	7,979	7,655
Supplementary capital before deductions	90,116	91,798
50% of unconsolidated investments	(63,286)	(53,749)
50% of securitisation positions and other deductions	(154)	(140)
Deductions	(63,440)	(53,889)
<b>Total supplementary capital</b>	<b>26,676</b>	<b>37,909</b>
<b>Capital base</b>	<b>267,184</b>	<b>246,206</b>

1 Includes the revaluation surplus on investment properties which is reported as part of retained profits and adjustments made in accordance with the Banking (Capital) Rules issued by the HKMA.

2 Includes adjustments made in accordance with the Banking (Capital) Rules issued by the HKMA.

3 Total regulatory reserve and collective impairment allowances are apportioned between the standardised approach and internal ratings-based approach in accordance with the Banking (Capital) Rules issued by the HKMA. Those apportioned to the standardised approach are included in supplementary capital. Those apportioned to the internal ratings-based approach are excluded from supplementary capital.

4 Excess impairment allowances over expected losses are applicable to non-securitisation exposures calculated by using the internal ratings-based approach.

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## 25. Principal subsidiaries and basis of consolidation

The basis of consolidation for accounting purposes is in accordance with Hong Kong Financial Reporting Standards ('HKFRS'). HKFRS is a collective term which includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Interpretations issued by the Hong Kong Institute of Certified Public Accountants.

The major subsidiaries of the Bank for accounting purposes are:

Hang Seng Bank Limited  
HSBC Bank (China) Company Limited  
HSBC Bank Malaysia Berhad  
HSBC Bank Australia Limited<sup>1</sup>  
HSBC Bank (Taiwan) Limited<sup>1</sup>  
HSBC Insurance (Asia) Limited<sup>1</sup>  
HSBC Life (International) Limited<sup>1</sup>

<sup>1</sup> Held indirectly

The basis of consolidation for regulatory purposes is different from the basis of consolidation for accounting purposes. Subsidiaries included in the consolidation for regulatory purposes are specified in a notice from the HKMA in accordance with section 98(2) of the Banking Ordinance. Subsidiaries not included in consolidation for regulatory purposes are securities and insurance companies that are authorised and supervised by a regulator and are subject to supervisory arrangements regarding the maintenance of adequate capital to support business activities comparable to those prescribed for authorised institutions under the Banking (Capital) Rules and the Banking Ordinance. The Bank's shareholdings in these subsidiaries are deducted from its core capital and supplementary capital as determined in accordance with Part 3 of the Banking (Capital) Rules.

With respect to notes 20, 21b and 24, the principal subsidiaries that are not included in the consolidation for regulatory purposes are:

Hang Seng Insurance Company Limited  
HSBC Insurance (Asia Pacific) Holdings Limited and subsidiaries  
HSBC Securities Japan Limited  
Hang Seng General Insurance (Hong Kong) Company Limited  
HSBC Securities Brokers (Asia) Limited

The group operates subsidiaries in a number of countries and territories where capital is governed by local rules and there may be restrictions on the transfer of regulatory capital and funds between members of the banking group.

**26. Statutory accounts**

The information in this document is not audited and does not constitute statutory accounts.

Certain financial information in this document is extracted from the statutory accounts for the year ended 31 December 2011 which have been delivered to the Registrar of Companies and the HKMA. The Auditors expressed an unqualified opinion on those statutory accounts in their report dated 27 February 2012. The Annual Report and Accounts for The Hongkong and Shanghai Banking Corporation Limited for the year ended 31 December 2011, which include the statutory accounts, can be obtained on request from Communications (Asia), The Hongkong and Shanghai Banking Corporation Limited, 1 Queen's Road Central, Hong Kong, and may be viewed on our website: [www.hsbc.com.hk](http://www.hsbc.com.hk).