



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 2013

Interim Disclosure Statement Supplementary Notes	Page
Introduction	2
1 Basis of preparation	2
2 Net interest income	3
3 Net fee income	3
4 Gains less losses on loans and receivables, held-to-maturity investments and financial liabilities measured at amortised cost	3
5 Dividend income	4
6 Cash and short-term funds	4
7 Placings with banks maturing after one month	4
8 Certificates of deposit	4
9 Loans and advances to customers	5
10 Non-bank Mainland exposures	10
11 Cross-border exposures	11
12 Financial investments	12
13 Interests in associates	12
14 Property, plant and equipment	13
15 Other assets	13
16 Trading liabilities	14
17 Financial liabilities designated at fair value	14
18 Debt securities in issue	14
19 Subordinated liabilities	15
20 Off-balance sheet exposures other than derivative transactions	16
21 Derivative transactions	16
22 Foreign exchange exposure	18
23 Liquidity ratio	19
24 Capital adequacy at 30 June 2013	20
25 Capital adequacy at 31 December 2012	23
26 Basis of consolidation	25
27 Statutory accounts	26

Appendices to this document are available in the Regulatory Disclosures section of our website:
www.hsbc.com.hk.

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 2013 Interim Consolidated Results - Highlights issued on 5 August 2013, available at 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, as amended by the Banking (Disclosure) (Amendment) Rules 2013 which came into operation on 30 June 2013.

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 banking book securitisation exposures. For market risk, the group uses an internal models approach to calculate its general market risk for the risk categories of interest rate exposures, foreign exchange (including gold) exposures, and equity exposures. The group also uses an internal models approach to calculate its market risk in respect of specific risk for interest rate exposures and equity exposures. The group uses the standardised (market risk) approach for calculating other market risk positions as well as trading book securitisation exposures, and the standardised (operational risk) approach to calculate its operational risk.

The Banking (Capital) (Amendment) Rules 2012, effective on 1 January 2013, implemented the first phase of the Basel III requirements in Hong Kong. Basel III makes significant changes to the definition of capital compared with Basel II, as well as changes to the calculation of risk weighted assets for credit risk. Consequently, as certain information included in this document has been calculated on a different basis between 30 June 2013 (Basel III) and 31 December 2012 (Basel II), it is not directly comparable. Certain comparative figures have not been provided where the current year is the first year of disclosure and provision is impracticable.

- 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 26.
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- 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 2012, as set out in Note 3 on the financial statements in the *Annual Report and Accounts 2012*.
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2. Net interest income

	Half-year ended 30 June 2013 HK\$m	Half-year ended 30 June 2012 HK\$m
Net interest income includes the following:		
- interest income accrued on impaired financial assets	<u>53</u>	<u>101</u>

3. Net fee income

	Half-year ended 30 June 2013 HK\$m	Half-year ended 30 June 2012 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	7,644	7,660
- fee expense	<u>(904)</u>	<u>(771)</u>
	<u>6,740</u>	<u>6,889</u>
Net fee income arising from trust and other fiduciary activities where the group holds or invests assets on behalf of its customers		
- fee income	4,395	4,426
- fee expense	<u>(477)</u>	<u>(560)</u>
	<u>3,918</u>	<u>3,866</u>

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

	Half-year ended 30 June 2013 HK\$m	Half-year ended 30 June 2012 HK\$m
Loans and receivables	<u>254</u>	<u>363</u>

There are no gains or losses on held-to-maturity investments or financial liabilities measured at amortised cost for the half-years ended 30 June 2013 and 30 June 2012.

5. Dividend income

	Half-year ended 30 June 2013 HK\$m	Half-year ended 30 June 2012 HK\$m
Listed investments	6	205
Unlisted investments	121	149
	<u>127</u>	<u>354</u>

6. Cash and short-term funds

	At 30 June 2013 HK\$m	At 31 December 2012 HK\$m
Cash in hand	17,824	17,925
Sight balances with central banks	79,120	196,179
Placing with banks with remaining maturity of one month or less	413,355	362,197
Treasury bills and other eligible bills	471,141	534,898
	<u>981,440</u>	<u>1,111,199</u>

At 30 June 2013, included within notes 6 and 7, the total amount placed with central banks, including sight balances, amounted to HK\$259,405m (31 December 2012: HK\$356,880m).

7. Placings with banks maturing after one month

	At 30 June 2013 HK\$m	At 31 December 2012 HK\$m
Gross placings with banks maturing after one month but not more than one year	172,696	150,504
Gross placings with banks maturing after one year	28,471	34,207
Total placings with banks maturing after one month	<u>201,167</u>	<u>184,711</u>

There are no significant overdue, impaired or rescheduled placings with banks at 30 June 2013 and 31 December 2012.

8. Certificates of deposit

	At 30 June 2013 HK\$m	At 31 December 2012 HK\$m
Held-to-maturity	10,833	8,426
Available-for-sale	89,373	84,659
	<u>100,206</u>	<u>93,085</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 subsidiaries in Hong Kong.

	Gross Advances		Collateral and other security	
	At 30 June 2013 HK\$m	At 31 December 2012 HK\$m	At 30 June 2013 HK\$m	At 31 December 2012 HK\$m
Gross loans and advances to customers for use in Hong Kong				
<i>Industrial, commercial and financial</i>				
Property development	74,105	68,345	22,673	21,530
Property investment	207,009	206,760	163,292	162,437
Financial concerns	14,600	13,533	8,420	3,020
Stockbrokers	4,841	3,373	374	680
Wholesale and retail trade	93,311	88,658	29,592	25,331
Manufacturing	37,702	33,904	8,150	7,566
Transport and transport equipment	32,458	27,328	20,533	19,402
Recreational activities	501	480	130	154
Information technology	10,631	5,741	1,179	1,390
Others	75,634	60,170	26,283	23,608
	550,792	508,292	280,626	265,118
<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	23,847	24,426	23,847	24,426
Advances for the purchase of other residential properties	347,385	336,906	347,385	336,906
Credit card advances	43,360	45,941	–	–
Others	42,260	39,554	10,381	9,522
	456,852	446,827	381,613	370,854
Gross loans and advances to customers for use in Hong Kong	1,007,644	955,119	662,239	635,972
Trade finance	221,165	166,521	28,621	26,784
Gross loans and advances to customers for use outside Hong Kong	1,261,802	1,237,174	465,871	445,386
Gross loans and advances to customers	2,490,611	2,358,814	1,156,731	1,108,142

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

Impaired loans and advances to customers are those loans and advances where objective evidence exists that full repayment of principal or interest is considered unlikely. Individually assessed allowances are made after taking into account the value of collateral in respect of such loans and advances.

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
At 30 June 2013			
Gross loans and advances to customers			
Individually assessed impaired gross loans and advances	2,758	8,167	10,925
Collectively assessed	1,416,505	1,063,181	2,479,686
Impaired loans and advances	550	881	1,431
Non-impaired loans and advances	1,415,955	1,062,300	2,478,255
Total gross loans and advances to customers	1,419,263	1,071,348	2,490,611
Impairment allowances	(3,335)	(5,688)	(9,023)
Individually assessed	(1,300)	(3,485)	(4,785)
Collectively assessed	(2,035)	(2,203)	(4,238)
Net loans and advances	1,415,928	1,065,660	2,481,588
Fair value of collateral which has been taken into account in respect of individually assessed impaired loan and advances to customers	1,180	3,933	5,113
Individually assessed impaired gross loans and advances as a percentage of gross loans and advances to customers	0.2%	0.8%	0.4%
Total allowances as a percentage of total gross loans and advances	0.2%	0.5%	0.4%
At 31 December 2012			
Gross loans and advances to customers			
Individually assessed impaired gross loans and advances	2,927	8,467	11,394
Collectively assessed	1,296,137	1,051,283	2,347,420
Impaired loans and advances	621	999	1,620
Non-impaired loans and advances	1,295,516	1,050,284	2,345,800
Total gross loans and advances to customers	1,299,064	1,059,750	2,358,814
Impairment allowances	(3,585)	(6,186)	(9,771)
Individually assessed	(1,418)	(3,827)	(5,245)
Collectively assessed	(2,167)	(2,359)	(4,526)
Net loans and advances	1,295,479	1,053,564	2,349,043
Fair value of collateral which has been taken into account in respect of individually assessed impaired loan and advances to customers	1,264	3,790	5,054
Individually assessed impaired gross loans and advances as a percentage of gross loans and advances to customers	0.2%	0.8%	0.5%

Total allowances as a percentage of total gross loans and advances 0.3% 0.6% 0.4%

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:

	Total gross loans and advances HK\$m	Gross impaired advances HK\$m	Individually assessed allowances HK\$m	Collectively assessed allowances HK\$m
At 30 June 2013				
Residential mortgages	693,562	2,343	(399)	(93)
Commercial, industrial and international trade	841,222	5,124	(2,780)	(1,819)
Commercial real estate	255,441	182	(122)	(96)
At 31 December 2012				
Residential mortgages	686,172	2,485	(428)	(122)
Commercial, industrial and international trade	745,198	5,117	(2,897)	(2,060)
Commercial real estate	249,264	533	(413)	(107)

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	%
At 30 June 2013						
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	439	0.0	1,770	0.2	2,209	0.1
– more than six months but less than one year	161	0.0	717	0.1	878	0.0
– more than one year	1,791	0.1	2,684	0.3	4,475	0.2
	2,391	0.1	5,171	0.6	7,562	0.3
Individually assessed impairment allowances made in respect of amounts overdue	(962)		(2,634)		(3,596)	
Fair value of collateral held in respect of amounts overdue	907		2,272		3,179	
Rescheduled loans and advances to customers	504	0.0	2,196	0.2	2,700	0.1
At 31 December 2012						
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	288	0.0	1,733	0.2	2,021	0.1
– more than six months but less than one year	166	0.0	1,283	0.1	1,449	0.1
– more than one year	1,856	0.1	2,828	0.3	4,684	0.2
	2,310	0.1	5,844	0.6	8,154	0.4
Individually assessed impairment allowances made in respect of amounts overdue	(895)		(3,008)		(3,903)	
Fair value of collateral held in respect of amounts overdue	769		2,285		3,054	
Rescheduled loans and advances to customers	565	0.0	2,781	0.3	3,346	0.1

1 Percentages shown are of gross loans and advances to customers.

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

	Hong Kong HK\$m	Rest of Asia-Pacific HK\$m	Other HK\$m	Total HK\$m
At 30 June 2013				
Gross loans and advances to customers	<u>1,167,917</u>	<u>1,142,613</u>	<u>180,081</u>	<u>2,490,611</u>
At 31 December 2012				
Gross loans and advances to customers	<u>1,090,273</u>	<u>1,087,788</u>	<u>180,753</u>	<u>2,358,814</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
At 30 June 2013				
Mainland entities	104,491	10,753	115,244	–
Companies and individuals outside the mainland where the credit is granted for use in the mainland	31,455	2,112	33,567	8
Other counterparties the exposures to whom are considered by the Bank to be non-bank mainland exposures	<u>3,426</u>	<u>2,367</u>	<u>5,793</u>	–
	139,372	15,232	154,604	8
Mainland exposures of wholly owned mainland subsidiaries:				
Loans and advances	167,797	2,392	170,189	159
Debt securities and other	<u>126,932</u>	<u>25,037</u>	<u>151,969</u>	–
	294,729	27,429	322,158	159
	434,101	42,661	476,762	167
At 31 December 2012				
Mainland entities	122,389	10,794	133,183	–
Companies and individuals outside the mainland where the credit is granted for use in the mainland	29,586	1,195	30,781	46
Other counterparties the exposures to whom are considered by the Bank to be non-bank mainland exposures	<u>3,703</u>	<u>2,537</u>	<u>6,240</u>	–
	155,678	14,526	170,204	46
Mainland exposures of wholly owned mainland subsidiaries:				
Loans and advances	147,122	3,544	150,666	138
Debt securities and other	<u>107,667</u>	<u>19,757</u>	<u>127,424</u>	–
	254,789	23,301	278,090	138
	410,467	37,827	448,294	184

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 ¹ HK\$m	Others HK\$m	Total HK\$m
At 30 June 2013				
Asia-Pacific excluding Hong Kong				
China	355,608	46,267	150,592	552,467
Others	181,790	157,187	295,472	634,449
	<u>537,398</u>	<u>203,454</u>	<u>446,064</u>	<u>1,186,916</u>
Americas				
United States	31,709	90,241	43,400	165,350
Others	31,371	16,604	100,576	148,551
	<u>63,080</u>	<u>106,845</u>	<u>143,976</u>	<u>313,901</u>
Europe	<u>185,671</u>	<u>41,129</u>	<u>110,550</u>	<u>337,350</u>
At 31 December 2012				
Asia-Pacific excluding Hong Kong				
China	312,712	18,708	157,617	489,037
Others	172,179	214,737	277,901	664,817
	<u>484,891</u>	<u>233,445</u>	<u>435,518</u>	<u>1,153,854</u>
Americas				
United States	21,249	115,285	34,315	170,849
Others	39,740	21,480	97,006	158,226
	<u>60,989</u>	<u>136,765</u>	<u>131,321</u>	<u>329,075</u>
Europe	<u>226,409</u>	<u>58,524</u>	<u>94,623</u>	<u>379,556</u>

¹ Includes balances with central banks

12. Financial investments

	At 30 June 2013 HK\$m	At 31 December 2012 HK\$m
Debt securities		
– held-to-maturity	161,003	155,393
– available-for-sale	472,127	463,278
Equity shares		
– available-for-sale	<u>36,822</u>	<u>7,371</u>
	<u>669,952</u>	<u>626,042</u>

There are no overdue debt securities at 30 June 2013 and 31 December 2012.

13. Interests in associates

	At 30 June 2013 HK\$m	At 31 December 2012 HK\$m
Interests in associates	<u>101,024</u>	<u>117,946</u>

14. Property, plant and equipment

	Land and buildings HK\$m	Investment properties HK\$m	Equipment HK\$m	Total HK\$m
Cost or valuation				
At 1 January 2013	80,104	5,282	22,228	107,614
Exchange and other adjustments	(191)	–	(327)	(518)
Additions	1,150	4,683	492	6,325
Disposals	(6)	–	(598)	(604)
Elimination of accumulated depreciation on revalued land and buildings	(978)	–	–	(978)
Surplus on revaluation	3,436	1,186	–	4,622
Reclassifications	97	(143)	–	(46)
At 30 June 2013	<u>83,612</u>	<u>11,008</u>	<u>21,795</u>	<u>116,415</u>
Accumulated depreciation				
At 1 January 2013	60	–	17,375	17,435
Exchange and other adjustments	(1)	–	(258)	(259)
Charge for the period	1,017	–	969	1,986
Disposals	–	–	(582)	(582)
Elimination of accumulated depreciation on revalued land and buildings	(978)	–	–	(978)
At 30 June 2013	<u>98</u>	<u>–</u>	<u>17,504</u>	<u>17,602</u>
Net book value at 30 June 2013	<u>83,514</u>	<u>11,008</u>	<u>4,291</u>	<u>98,813</u>
Net book value at 31 December 2012	<u>80,044</u>	<u>5,282</u>	<u>4,853</u>	<u>90,179</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 2013 HK\$m	At 31 December 2012 HK\$m
Repossessed assets	<u>91</u>	<u>144</u>

There are no significant overdue other assets at 30 June 2013 and 31 December 2012.

16. Trading liabilities

	At 30 June 2013 HK\$m	At 31 December 2012 HK\$m
Certificates of deposit in issue	3,518	3,470
Other debt securities in issue	17,622	15,479
Short positions in securities	55,305	48,116
Deposits by banks	7,239	7,982
Customer accounts	112,860	108,293
	<u>196,544</u>	<u>183,340</u>

17. Financial liabilities designated at fair value

	At 30 June 2013 HK\$m	At 31 December 2012 HK\$m
Deposits by banks	235	271
Customer accounts	1,182	1,366
Debt securities in issue	8,568	6,414
Liabilities to customers under investment contracts	35,892	36,219
	<u>45,877</u>	<u>44,270</u>

18. Debt securities in issue

	At 30 June 2013 HK\$m	At 31 December 2012 HK\$m
Certificates of deposit	24,605	29,066
Other debt securities	50,184	45,581
	<u>74,789</u>	<u>74,647</u>

The above debt securities in issue are carried at amortised cost.

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 2013 HK\$m	At 31 December 2012 HK\$m
<i>Bank</i>			
US\$1,200m	Primary capital undated floating rate notes	9,355	9,355
<i>Group</i>			
AUD42m	Floating rate subordinated notes due 2018, callable from 2013 ¹	–	338
AUD200m	Floating rate subordinated notes due 2020, callable from 2015	1,423	1,608
MYR500m	Fixed rate (4.35%) subordinated bonds due 2022, callable from 2017 ²	1,227	1,267
MYR500m	Fixed rate (5.05%) subordinated bonds due 2027, callable from 2022 ³	1,252	1,299
		<u>13,257</u>	<u>13,867</u>

1 The AUD42m callable subordinated floating rate notes due 2018 were redeemed in March 2013.

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

3 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 2013 HK\$m	At 31 December 2012 HK\$m
Contingent liabilities and commitments		
Direct credit substitutes	70,458	69,044
Transaction-related contingencies	124,440	124,065
Trade-related contingencies	107,139	107,558
Forward asset purchases	3,160	2,457
Forward forward deposits placed	1,434	–
Commitments that are unconditionally cancellable without prior notice	1,328,373	1,290,390
Commitments which have an original maturity of not more than one year	89,247	97,458
Commitments which have an original maturity of more than one year	156,070	150,716
	<u>1,880,321</u>	<u>1,841,688</u>
Risk-weighted amounts	<u>224,087</u>	<u>214,479</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 3C(1) of the Banking (Capital) Rules.

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 2013 HK\$m	At 31 December 2012 HK\$m
Exchange rate	13,173,736	12,207,398
Interest rate	20,197,494	18,277,568
Credit derivative	288,490	335,214
Equity, commodity and other	1,229,757	932,769
	<u>34,889,477</u>	<u>31,752,949</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

	Contract amount HK\$m	Risk- weighted amount HK\$m	Fair value HK\$m
At 30 June 2013			
Exchange rate	11,283,549	71,209	78,398
Interest rate	15,585,356	23,766	32,191
Credit derivative	308,244	1,455	766
Equity, commodity and other	632,698	6,494	15,245
	<u>27,809,847</u>	<u>102,924</u>	<u>126,600</u>
At 31 December 2012			
Exchange rate	10,961,513	50,905	63,821
Interest rate	14,802,764	24,029	30,110
Credit derivative	359,388	1,098	302
Equity, commodity and other	370,273	3,971	8,070
	<u>26,493,938</u>	<u>80,003</u>	<u>102,303</u>

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 3C(1) of the Banking (Capital) Rules.

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. Fair value is calculated after taking into account the effect of valid bilateral netting agreements amounting to HK\$240,493m at 30 June 2013 (31 December 2012: HK\$289,275m).

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's foreign exchange exposures in the tables below are prepared in accordance with the HKMA return "Foreign Currency Position Return" (MA (BS) 6).

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
At 30 June 2013		
Chinese renminbi	126,904	159,346
At 31 December 2012		
Chinese renminbi	153,638	189,446

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	Korea won HK\$m	Chinese renminbi HK\$m
As 30 June 2013					
Spot assets	1,431,376	275,461	18,163	90,889	587,017
Spot liabilities	(1,560,936)	(226,796)	(22,790)	(81,971)	(523,962)
Forward purchases	6,795,355	376,217	502	612,742	1,324,182
Forward sales	(6,649,835)	(420,918)	(570)	(621,693)	(1,390,432)
Net options positions	3,134	(17)	-	(44)	(469)
	<u>19,094</u>	<u>3,947</u>	<u>(4,695)</u>	<u>(77)</u>	<u>(3,664)</u>
As 31 December 2012					
Spot assets	1,401,014	255,743	18,949	65,400	529,950
Spot liabilities	(1,599,404)	(235,337)	(23,941)	(22,994)	(508,122)
Forward purchases	6,365,644	558,434	3,822	533,171	1,018,430
Forward sales	(6,162,237)	(574,195)	(3,801)	(574,781)	(1,040,813)
Net options positions	3,205	(268)	-	529	(215)
	<u>8,222</u>	<u>4,377</u>	<u>(4,971)</u>	<u>1,325</u>	<u>(770)</u>

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

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:

	Half-year ended 30 June 2013 %	Half-year ended 30 June 2012 %
Hong Kong branches of the Bank	<u>37.5</u>	<u>37.7</u>

24. Capital adequacy at 30 June 2013

The following tables show the capital ratios, risk weighted assets and capital base 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 3C(1) of the Banking (Capital) Rules.

On 1 January 2013, the HKMA implemented the first phase of the Basel III capital framework in Hong Kong. The capital disclosures for June 2013 under Basel III are, therefore, not directly comparable with the disclosures for December 2012 prepared under the Basel II basis.

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 2013, the effect of this requirement is to restrict the amount of reserves which can be distributed to shareholders by HK\$21,102m (31 December 2012: HK\$19,426m).

There are no relevant capital shortfalls in any of the group's subsidiaries at 30 June 2013 (31 December 2012: Nil) which are not included in its consolidation group for regulatory purposes.

a. Capital ratios

	At 30 June 2013 %
Common Equity Tier 1 (CET1) capital	14.2
Tier 1 capital	14.2
Total capital	15.5

b. Risk weighted assets by risk type

	At 30 June 2013 HK\$m
Credit risk	1,751,768
Counterparty risk	190,141
Market risk	109,775
Operational risk	259,889
Total	<u>2,311,573</u>

The following table sets out the composition of the group's capital base under Basel III at 30 June 2013. The position at 30 June 2013 benefits from transitional arrangements which will be phased out. The table also shows the pro-forma position once all transitional arrangements have been phased out based on the Transition Disclosures Template. A more detailed breakdown of the capital position on these bases is available in the Regulatory Disclosures section of our website www.hsbc.com.hk.

It should be noted that the pro-forma position once all transitional arrangements have been phased out takes no account of, for example, any future profits or management actions. In addition, the current regulations or their application may change before full implementation. Given this, the final impact on the group's capital ratios may differ from the pro-forma position, which is a mechanical application of the current rules to the balance sheet at 30 June 2013; it is not a projection. On this pro-forma basis, the group's CET1 ratio is 10.3%, which is above the Basel III minimum requirement, including the capital conservation buffer.

24. Capital adequacy at 30 June 2013 (continued)*c. Capital base*

	At 30 June 2013 HK\$m	Fully phased-in position HK\$m
Common Equity Tier 1 ('CET1') capital		
Shareholders' equity	409,136	409,136
Shareholders' equity per balance sheet	450,982	450,982
Revaluation reserve capitalisation issue	(1,454)	(1,454)
Unconsolidated subsidiaries	(40,392)	(40,392)
Non-controlling interests	23,581	23,581
Non-controlling interests per balance sheet	39,359	39,359
Non-controlling interests in unconsolidated subsidiaries	(3,919)	(3,919)
Portion not eligible for inclusion in CET1 capital	(11,859)	(11,859)
Regulatory deductions to CET1 capital	(104,883)	(194,118)
Valuation adjustments	(2,700)	(2,700)
Goodwill and intangible assets	(16,968)	(16,968)
Deferred tax assets net of deferred tax liabilities	(1,945)	(1,945)
Cash flow hedging reserve	(153)	(153)
Changes in own credit risk on fair valued liabilities	(1,634)	(1,634)
Defined benefit pension fund assets	(78)	(78)
Significant capital investments in unconsolidated financial sector entities	(521)	(100,757)
Property revaluation reserves ¹	(48,781)	(48,781)
Regulatory reserve	(21,102)	(21,102)
Excess AT1 deductions	(11,001)	–
Total CET1 capital	327,834	238,599
Additional Tier 1 ('AT1') capital		
Total AT1 capital before regulatory deductions	39,117	2,229
Perpetual non-cumulative preference shares	30,663	–
Non-controlling interests eligible for inclusion in AT1 capital	8,454	2,229
Regulatory deductions to AT1 capital	(39,117)	–
Significant capital investments in unconsolidated financial sector entities	(50,118)	–
Excess AT1 deductions	11,001	–
Total AT1 capital	–	2,229
Total Tier 1 capital	327,834	240,828
Tier 2 capital		
Total Tier 2 capital before regulatory deductions	84,492	38,191
Perpetual cumulative preference shares	8,416	–
Cumulative term preferences shares	15,126	–
Perpetual subordinated debt	9,355	–
Term subordinated debt	15,731	2,327
Property revaluation reserves ¹	22,606	22,606
Impairment allowances and regulatory reserve eligible for inclusion in Tier 2 capital	12,624	12,624
Non-controlling interests eligible for inclusion in Tier 2 capital	634	634
Regulatory deductions to Tier 2 capital	(52,975)	(2,857)
Significant capital investments in unconsolidated financial sector entities	(52,975)	(2,857)
Total Tier 2 capital	31,517	35,334
Total capital	359,351	276,162

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.

24. Capital adequacy at 30 June 2013 (continued)*d. Capital instruments*

The following is a summary of the group's CET1, AT1 and Tier 2 capital instruments at 30 June 2013.

	Par value	Amount recognised in regulatory capital HK\$m
CET1 capital instruments		
Ordinary shares: 23,587,482,901 issued and fully paid ordinary shares of HK\$2.50 each.	HK\$58,969m	<u>57,515</u>
AT1 capital instruments		
Perpetual non-cumulative preference shares	US\$3,953m	<u>30,663</u>
Tier 2 capital instruments		
Perpetual cumulative preference shares	US\$1,085m	<u>8,416</u>
Cumulative preference shares due 2019	US\$ 500m	3,878
Cumulative preference shares due 2023	US\$ 400m	3,103
Cumulative preference shares due 2024	US\$1,050m	<u>8,145</u>
		<u>15,126</u>
Primary capital undated floating rate notes	US\$1,200m	<u>9,355</u>
Subordinated loan due 2020	US\$ 775m	6,012
Subordinated loan due 2021	US\$ 450m	3,490
Subordinated loan due 2022	US\$ 300m	2,327
Floating rate subordinated notes due 2020, callable from 2015	AUD 200m	1,423
Fixed rate (4.35%) subordinated bonds due 2022, callable from 2017	MYR 500m	1,227
Fixed rate (5.05%) subordinated bonds due 2027, callable from 2022	MYR 500m	<u>1,252</u>
		<u>15,731</u>

e. Additional information

A description of the main features, and the full terms and conditions of the group's capital instruments can be found in the Regulatory Disclosures section of our website www.hsbc.com.hk.

A detailed breakdown of the group's CET1 capital, AT1 capital, Tier 2 capital and regulatory deductions can be viewed in the Interim Disclosure Statement Supplementary Notes Appendices that can be found in the Regulatory Disclosures section of our website www.hsbc.com.hk.

A full reconciliation between the group's accounting and regulatory balance sheets can be viewed in the Interim Disclosure Statement Supplementary Notes Appendices that can be found in the Regulatory Disclosures section of our website www.hsbc.com.hk.

25. Capital adequacy at 31 December 2012*a. Capital ratios*

	At 31 December 2012 %
Core capital ratio	13.7
Capital adequacy ratio	14.3

b. Risk weighted assets by risk type

	At 31 December 2012 HK\$m
Credit risk	1,455,675
Counterparty risk	81,409
Market risk	116,911
Operational risk	250,139
Total	<u>1,904,134</u>

c. Deductible items

	At 31 December 2012 HK\$m
Total of items deductible 50% from core capital and 50% from supplementary capital	<u>135,416</u>

25. Capital adequacy at 31 December 2012 *(continued)**d. Capital base*

	At 31 December 2012 HK\$m
Core capital:	
Share capital per balance sheet	58,969
Revaluation reserve capitalisation issue	(1,454)
Paid-up ordinary share capital	<u>57,515</u>
Paid-up irredeemable non-cumulative preference shares	<u>51,570</u>
Reserves per balance sheet	378,430
Proposed dividend	(20,000)
Unconsolidated subsidiaries	(40,088)
Cash flow hedging reserve	(210)
Regulatory reserve	(19,426)
Reserves arising from revaluation of property and unrealised gains on available-for-sale equities and debt securities	(86,111)
Unrealised gains on equities and debt securities designated at fair value	(20)
Own credit spread	(218)
Total reserves included in core capital	<u>212,357</u>
Non-controlling interests per balance sheet	35,679
Non-controlling interests in unconsolidated subsidiaries	(3,478)
Regulatory adjustments to non-controlling interests	(3,291)
Non-controlling interests	<u>28,910</u>
Goodwill and intangible assets and valuation adjustments	(21,191)
50% of unconsolidated investments	(67,692)
50% of securitisation positions and other deductions	(16)
Deductions	<u>(88,899)</u>
Total core capital	<u>261,453</u>
Supplementary capital:	
Paid-up irredeemable cumulative preference shares	16,510
Perpetual subordinated debt	9,355
Paid-up term preference shares	15,115
Term subordinated debt	16,418
Property revaluation reserves ¹	7,977
Unrealised gains on available-for-sale equities and debt securities ²	2,534
Unrealised gains on equities and debt securities designated at fair value	9
Regulatory reserve ³	2,333
Collective impairment allowances ³	496
Excess impairment allowances over expected losses ⁴	8,400
Supplementary capital before deductions	<u>79,147</u>
50% of unconsolidated investments	(67,692)
50% of securitisation positions and other deductions	(16)
Deductions	<u>(67,708)</u>
Total supplementary capital	<u>11,439</u>
Capital base	<u>272,892</u>

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.

26. Basis of consolidation

The basis of consolidation for financial accounting purposes is in accordance with Hong Kong Financial Reporting Standards ('HKFRS'), as described in Note 1 on the financial statements in the *Annual Report and Accounts 2012*. This basis differs from the basis of consolidation used for regulatory purposes applied in notes 20, 21b, 24 and 25 of this document.

Subsidiaries included in the consolidation for regulatory purposes are specified in a notice from the HKMA in accordance with section 3C(1) of the Banking (Capital) Rules. 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 capital invested by the group in these subsidiaries is deducted from the capital base as determined in accordance with Part 3 of the Banking (Capital) Rules.

A list of these subsidiaries is shown below:

	Principal activity	At 30 June 2013	
		Total assets HK\$m	Total equity HK\$m
HSBC Broking Services (Asia) Ltd and its subsidiaries	Broking services	18,593	2,461
HSBC Futures (Singapore) Pte Ltd	Futures broking	68	66
HSBC Global Asset Management Holdings (Bahamas) Ltd and its subsidiaries	Asset management	2,056	1,422
HSBC Insurance (Asia- Pacific) Holdings Ltd and its subsidiaries	Insurance	254,510	32,743
HSBC InvestDirect (India) Ltd and its subsidiaries	Financial Services	1,004	597
HSBC Securities (Asia) Ltd and its subsidiaries	Broking services	420	419
HSBC Securities (Japan) Ltd	Broking services	43,959	1,338
HSBC Securities Brokers (Asia) Ltd	Broking services	9,488	907
Hang Seng (Nominee) Ltd	Nominee services	-	-
Hang Seng Bank (Trustee) Ltd	Trustee services	5	3
Hang Seng Bank Trustee International Ltd	Trust business	16	11
Hang Seng Futures Ltd	Futures broking	103	102
Hang Seng Insurance (Bahamas) Ltd	Insurance	49	49
Hang Seng Insurance Co. Ltd and its subsidiaries	Insurance	102,167	13,042
Hang Seng Investment management Ltd	Asset management	598	556
Hang Seng Investment Services Ltd	Investment services	9	9
Hang Seng Securities Ltd	Broking services	3,051	1,527

There are no subsidiaries which are included within both the accounting scope of consolidation and the regulatory scope of consolidation but where the method of consolidation differs at 30 June 2013.

There are no subsidiaries which are included within the regulatory scope of consolidation but not included within the accounting scope of consolidation at 30 June 2013.

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.

27. 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 2012 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 4 March 2013. The Annual Report and Accounts for The Hongkong and Shanghai Banking Corporation Limited for the year ended 31 December 2012, 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.