2011

The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch

Pillar 3 Disclosures at 31 December 2011

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Cautionary statement regarding forward-looking statements

The *Pillar 3 Disclosures 2011* contains certain forward-looking statements with respect to the financial condition of The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch ('the Bank'), results of operations and business.

Statements that are not historical facts, including statements about the Bank's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible', variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them.

Forward-looking statements speak only as of the date they are made. The Bank makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statements.

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement. These factors include changes in general economic conditions in the markets in which we operate, changes in government policy and regulation and factors specific to the Bank.

Introduction

The Bank calculates capital according to the announcement of the Bank of Thailand ('the BoT') regarding a capital adequacy framework based on the 'International Convergence of Capital Measurement and Capital Standards' (commonly known as 'Basel II') issued by the Basel Committee on Banking Supervision ('BCBS').

The supervisory objectives of Basel II are to promote safety and soundness in the financial system and maintain an appropriate level of capital in the system, enhance competitive equality, constitute a more comprehensive approach to addressing risks, and focus on internationally active banks. Basel II is structured around three 'pillars': pillar 1, 'minimum capital requirements', pillar 2, 'supervisory review' and pillar 3, 'market discipline'.

Pillar 3 disclosures 2011

Pillar 3, market discipline, complements the minimum capital requirements and the supervisory review process. Its aim is to encourage market discipline by developing a set of disclosure requirements which allow market participants to assess certain specified information on the scope of application of Basel II, capital, particular risk exposures, risk assessment processes, and hence the capital adequacy of the institution. Disclosures consist of both quantitative and qualitative information.

Frequency

In accordance with the BoT's requirements, the Bank publishes comprehensive Pillar 3 disclosures annually with an update of certain quantitative capital requirement disclosures, including market risk information, at the half year.

Media and location

The *Pillar 3 Disclosures 2011* of the Bank on a standalone basis are available on the Bank's website: www.hsbc.co.th, whereas the Pillar 3 Disclosures 2011 of HSBC Holdings plc and its subsidiaries ('HSBC' or 'Group') on a consolidated level and other information on HSBC are available on HSBC Group's website: www.hsbc.com.

Verification

The *Pillar 3 Disclosures 2011* have been appropriately verified internally, but have not been audited by the external auditor.

Scope of Basel II permissions

Credit risk

Basel II applies three approaches of increasing sophistication to the calculation of pillar 1 credit risk capital requirements. The most basic level, the standardised approach ('SA'), requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties. Other counterparties are grouped into broad categories and standardised risk weightings are applied to these categories. The next level, the internal ratings-based ('IRB') foundation approach, allows banks to calculate their credit risk capital requirements on the basis of their internal assessment of a counterparty's probability of default ('PD'), but subjects their quantified estimates of exposure at default ('EAD') and loss given default ('LGD') to standard supervisory parameters. Finally, the IRB advanced approach allows banks to use their own internal assessment in both determining PD and quantifying EAD and LGD.

For credit risk, with the BoT's approval, the Bank has adopted the standardised approach.

Counterparty credit risk in both the trading and non-trading books is the risk that the counterparty to a transaction may default before completing the satisfactory settlement of the transaction. Three approaches to calculating counterparty credit risk and determining exposure values are defined by Basel II: standardised, mark-to-market and internal model method ('IMM'). These exposure values are used to determine capital requirements under one of the credit risk approaches; standardised, IRB foundation and IRB advanced.

Internally, the Bank uses the mark-to-market and IMM approaches for managing and monitoring its counterparty credit risk.

Market risk
Market risk is the risk that movements in market risk factors, including foreign exchange rates, commodity prices, interest rates, credit spreads and equity prices will reduce the Bank's income or the value of its portfolios.

The Bank has obtained approval from the BoT to apply a combined approach for market risk assessment to determine capital requirement. The standardised approach is used for Specific Interest Rate Risk and the Value at Risk ('VaR') model is used for general market, foreign exchange and interest rate risk.

Operational risk
Basel II also includes capital requirements for operational risk, again utilising three levels of sophistication. The capital required under the basic indicator approach is a simple percentage of gross revenues, whereas under the standardised approach it is one of three different percentages of gross revenues allocated to each of eight defined business lines. Both these approaches use an average of the last three financial years' revenues. Finally, the advanced measurement approach uses banks' own statistical analysis and modelling of operational risk data to determine capital requirements.

The Bank has adopted the standardised approach in determining its operational risk capital requirements.

Capital

Capital management and allocation
Our approach to capital management is driven by our strategic and organisational requirements, taking into account the regulatory, economic and commercial environment in which we operate. It is our objective to maintain a strong capital base to support the development of our business and to meet regulatory capital requirements at all times.

Our policy on capital management is underpinned by a capital management framework, which enables us to manage our capital in a consistent and aligned manner. The framework, which is approved by the Group Management Board ('GMB'), incorporates a number of different capital measures including market capitalisation, invested capital, economic capital and regulatory capital. Our strategy is to allocate capital to businesses based on their economic profit generation, regulatory and economic capital requirements and the cost of capital.

At 31 December 2011, 30 June 2011 and 31 December 2010, the Bank has an allocated and registered capital fund with the BoT of Baht 11,649 million, Baht 10,349 million and Baht 10,349 million, respectively. The detail can be summarised as follows:

Table 1 : The Bank's Capital Structure at 31 December 2011, 30 June 2011 and 31 December 2010

	31 December 2011 THBm	30 June 2011 THBm	31 December 2010 THBm
Assets maintained under Section 32	**12,116**	**10,874**	**10,855**
Sum of net capital for maintenance of assets under Section 32 and net balance of inter-office accounts			
Capital for maintenance of assets under Section 32	11,649	10,349	10,349
Net balance of inter-office accounts where the branch is the debtor to the head office and other branches located in other countries, the parent company and subsidiaries of the head office	14,032	16,700	18,508
Total	**25,681**	**27,049**	**28,857**
Total Capital Fund	**11,649**	**10,349**	**10,349**

Table 2 : The Bank's Capital Adequacy at 31 December 2011, 30 June 2011 and 31 December 2010

Minimum capital requirement for credit risk classified by type of assets under the Standardised Approach

	31 December 2011 THBm	**30 June 2011 THBm**	**31 December 2010 THBm**
Performing claims			
Claims on sovereigns and central banks, and multilateral development banks (MDBs)	22	14	20
Claims on financial institutions, non-central government public sector entities (PSEs) treated as claims on financial institutions, and securities firms	762	580	764
Claims on corporates, non-central government public sector entities (PSEs) treated as claims on corporates	3,878	3,751	3,477
Claims on retail portfolios	925	872	840
Claims on housing loans	93	90	86
Other assets	70	79	67
		0	
Non-performing claims	39	38	60
Total minimum capital requirement for credit risk	**5,789**	**5,424**	**5,314**

Minimum capital requirement for market risk for positions in the trading book

	31 December 2011 THBm	**30 June 2011 THBm**	**31 December 2010 THBm**
Internal model approach	248	229	244
Total minimum capital requirement for market risk	**248**	**229**	**244**

Remark:

- *The Bank has approval from the Bank of Thailand to apply a combined approach for market risk. The standardised approach is applied for specific interest rate risk and the internal model approach is applied for general interest rate risk and foreign exchange rate risk.*
- *Since the Bank holds only THB Government bonds and the total amount of the portfolio is less than the Bank's THB liability, a zero percent risk weight was applied according to the Bank of Thailand regulations. Therefore, there is no capital requirement for the specific interest rate risk under the standardised approach at 31 December 2011, 30 June 2011 and 31 December 2010.*

Minimum capital requirement for operational risk

	31 December 2011 THBm	**30 June 2011 THBm**	**31 December 2010 THBm**
Standardised approach	926	931	935
Total minimum capital requirement for operational risk	**926**	**931**	**935**

The Bank's capital ratio

	31 December 2011 %	**30 June 2011 %**	**31 December 2010 %**
Total capital to risk-weighted assets	**12.6**	**11.8**	**12.0**

Risk exposure and assessment

Risk management objectives and policies

Overview

Our activities – whether lending, payment transmission, trading business to support clients and markets, or maintenance of our infrastructure for delivering financial services –involve to varying degrees the measurement, evaluation, acceptance and management of risks. The most important risk categories that the Group is exposed to are credit risk (including cross-border country risk), market risk, operational risk in various forms, liquidity risk, insurance risk, pension risk, residual value risk, reputational risk and sustainability (environmental and social) risk. Market risk includes foreign exchange, interest rate and equity price risks.

The objective of risk management, shared across the organisation, is to support Group strategies to build sustainably profitable business in the best long-term interests of our shareholders and other stakeholders. We aim to ensure that risk management is firmly embedded in how we run our business through:

- a historically strong risk culture, with personal accountability for decisions;
- a formal governance structure, with a clear, well understood framework of risk ownership, standards and policy;
- the alignment of risk and business objectives, and integration of risk appetite and stress testing into business planning and capital management; and
- an independent, integrated and specialist Global Risk function.

Our risk culture is a major strength of the Group, and fostering it is a key responsibility of senior executives assisted by the Global Risk function. All employees are held accountable for identifying, assessing and managing risks within the scope of their assigned responsibilities. A primary duty of the senior management in each country in which we operate is to implement and maintain an effective risk strategy to address all risks in the business they manage, and we have a system of personal, not collective, authorities for lending decisions. Personal accountability, reinforced by learning and development, helps sustain a disciplined and constructive culture of risk management and control throughout HSBC.

As risk is not static, our risk profile continually alters as a result of change in the scope and impact of a wide range of factors, from geopolitical to transactional. The risk environment requires continual monitoring and holistic assessment in order to understand and manage the complex interactions across the Bank.

The Global Risk function, headed by the Group Chief Risk Officer ('GCRO'), provides an expert, integrated and independent assessment of risks across the Group:

- supporting our regions and global businesses in the development and achievement of strategic objectives;
- partnering the business in risk appetite planning and operation;
- carrying out central approvals, controls, risk systems leadership and the analysis and reporting of management information;
- fostering development of the Global Risk function and the Group's risk culture; and
- addressing risk issues in dealings with external stakeholders including regulators and analysts.

In addition to 'business as usual' operations, the Global Risk function engages fully with business development activities such as new product approval and post-implementation review, and acquisition due diligence.

In Thailand, the Bank has established a Risk Management Committee ('RMC') which is chaired by the Chief Executive Officer ('CEO') with membership made up of senior managers. The RMC is the Bank's senior designated risk management committee as defined by the HSBC Regional Office in Hong Kong which is responsible for setting risk appetite and approving definitive risk policies and controls.

The members of Risk Management Committee are the Chief Risk Officer, Chief Financial Officer, Chief Technology and Services Officer, Treasurer, Head of Global Banking, Head of Commercial Banking and Head of Retail Banking and Wealth Management. The RMC meeting is chaired by CEO and convened on a monthly basis.

Group policy
Our risk management policies, encapsulated in the Group Standards Manual and cascaded through a hierarchy of policy manuals across the Group, are designed to support the formulation of risk appetite, guide employees and establish procedures for monitoring and controlling risks, with timely and reliable reporting to management.

HSBC's risk management policies are designed to identify and analyse risks, to set appropriate risk limits and controls and to monitor the risks and adherence to limits by means of reliable and up-to-date administrative and information systems. The Bank regularly reviews and updates our risk management policies, systems and methodologies to reflect changes in law, regulation, markets, products and emerging best practice.

It is a prime responsibility of the Bank's management to identify, assess and manage the broad spectrum of risks to which the Bank is subject. All employees moreover are expected to manage risk within the scope of their assigned responsibilities. Personal accountability, reinforced by the Bank's governance structure and instilled by training and experience, helps to foster a disciplined and constructive culture of risk management and control.

Risk appetite
Risk appetite is a key component of our management of risk. Our approach is designed to reinforce the integration of risk considerations into key business goals and planning processes. Preserving our strong capital position remains a key priority and the level of integration of our risk and capital management helps to optimise our response to business demand for regulatory and economic capital.

Risk measurement and reporting systems
The purpose of our risk measurement and reporting systems is to ensure that, as far as possible, risks are comprehensively captured, with all the attributes necessary to support well-founded decisions, that those attributes are accurately assessed and that information is delivered in a timely way to the right points in the organisation for those risks to be successfully managed and mitigated.

Risk measurement and reporting systems are also subject to a robust governance framework, to ensure that their design is fit for purpose and that they are functioning properly. Group risk information technology ('IT') systems development is a key responsibility of the GCRO, while the operation and development of risk rating and management systems and processes are ultimately subject to the oversight of the Board.

We invest significant resources in IT systems and processes in order to maintain and improve our risk management capabilities. Group policy promotes the deployment of preferred technology where practicable. Group standards govern the procurement and operation of systems used in the Group, processing risk information within business lines and risk functions. The measurement and monitoring of the major risks we encounter, including credit, market and operational risks, are increasingly delivered by central systems or, where this is not the case for sound business reasons, through structures and processes that support comprehensive oversight by senior management.

Internal assessment of capital adequacy

We assess the adequacy of our capital by considering the resources necessary to cover unexpected losses arising from discretionary risks, such as credit risk and market risk, or non-discretionary risks, such as operational risk and reputational risk. The framework, together with related policies, define the Internal Capital Adequacy Assessment Process ('the ICAAP') by which GMB examines our risk profile from both regulatory and economic capital viewpoints and ensures that our level of capital:

- remains sufficient to support our risk profile and outstanding commitments;
- exceeds our formal minimum regulatory capital requirements;
- is capable of withstanding a severe economic downturn stress scenario; and
- remains consistent with our strategic and operational goals.

We identify and manage the risks we face through defined internal control procedures and stress testing. We assess and manage certain risks outlined below via a capital planning process.

Credit, market and operational risk

We assess capital requirements for these risk types by utilising the embedded operational infrastructure used for the pillar 1 capital calculation, together with an additional suite of models that take into account, in particular diversification of risks within our portfolios and, similarly, any concentrations of risk that arise.

Our capital assessment operates alongside the regulatory capital process and consistently demonstrates a lower overall capital requirement for credit risk than the regulatory equivalent, reflecting the benefits of global diversification. However, we maintain a prudent stance on capital coverage, ensuring that any model risk is mitigated.

Interest rate risk in the banking book

Interest Rate Risk in the Banking Book ('IRRBB') is defined as the exposure of our non-trading products to interest rates.

This risk arises in such portfolios principally from mismatches between the future yield on assets and their funding costs, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts.

Liquidity risk

Liquidity risk arises from mismatches in the timing of cash flows. Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.

The objective of our liquidity and funding management framework is to ensure that all foreseeable funding commitments can be met when due, and that access to the wholesale markets is co-ordinated and cost-effective.

To this end, we maintain a diversified funding base comprising core retail and corporate customer deposits and institution balances. We augment this with wholesale funding and portfolios of highly liquid assets diversified by currency and maturity which are held to enable us to respond quickly and smoothly to unforeseen liquidity requirements.

We use cash-flow stress testing as part of our control processes to assess liquidity risk. We do not manage liquidity through the explicit allocation of capital as, in common with standard industry practice, this is not considered to be an appropriate or adequate mechanism for managing these risks. However, we recognise that a strong capital base can help to mitigate liquidity risk both by providing a capital buffer to allow an entity to raise funds and deploy them in liquid positions and by serving to reduce the credit risk taken by providers of funds to the Group.

Reputational risk

As a banking group, our good reputation depends upon the way in which we conduct our business, but it can also be affected by the way in which clients to whom we provide financial services conduct themselves.

HSBC in Thailand manages and monitors our reputational risk via the RMC. The Bank monitors reputational risk on a daily basis and informs local senior management in a timely manner if there are occurrences of any reputational risk events.

Business risk

Business risk is the potential negative impact on profits and capital as a result of the Bank not meeting our strategic objectives, as set out in the rolling operating plan, caused by unforeseen changes in the business and regulatory environment, exposure to economic cycles and technological changes.

We manage and mitigate business risk through our business planning and stress testing processes, so that our business model and planned activities are resourced and capitalised consistent with the commercial, economic and risk environment in which the Group operates and that the potential vulnerability of our business plans are identified at an early stage so that mitigating actions can be taken proactively.

Credit risk

General information on credit risk exposure

Credit risk is the risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises principally from direct lending and trade finance, but also from off-balance sheet products such as guarantees and derivatives. Credit risk generates the largest regulatory capital requirement of the risks we incur. This includes a capital requirement for counterparty credit risk in the banking and trading books.

The principal objectives of our credit risk management are:

- to maintain a strong culture of responsible lending, and a robust risk policy and control framework;
- to both partner and challenge our business in defining and implementing and continually re-evaluating our risk appetite under actual and stress scenario conditions; and
- to ensure there is independent, expert scrutiny of credit risks, their costs and their mitigation.

The Bank uses the Standardised Approach to calculate capital requirement for credit risks. Non-performing claims represent classified assets/loans under substandard, doubtful, doubtful loss and loss accounts according to the BoT's guideline. The specific provision has been provided for non-performing assets/loans based on the estimated losses which were calculated by discounting expected future cash flows (inclusive of the value of security). The general provision has been calculated based on collective impairment for both corporate and retail loans portfolio for which historical loss rate experience, time value and economic factors have been taken into account.

The following tables set out credit risk exposure value according to regulatory requirement at 31 December 2011 and 2010.

Credit risk

General information on credit risk exposure

Table 3 : Credit risk exposure of significant on-balance sheet and off-balance sheet exposures before recognised credit risk mitigation at 31 December 2011 and 2010

	31 December 2011		31 December 2010	
	Average exposure value THBm	Exposure value THBm	Average exposure value THBm	Exposure value THBm
On-balance sheet				
Loans and advances, net	153,278	142,412	133,526	147,433
Investments in debt securities, net	30,135	41,728	28,575	22,849
Deposits (including accrued interest receivable)	2,310	1,840	1,912	857
Total	**185,723**	**185,980**	**164,013**	**171,139**
Off-balance sheet				
Aval, guarantees and letter of credit	4,459	2,919	3,711	3,952
OTC derivatives	3,055,518	3,384,086	2,405,530	2,730,571
Undrawn commitment	99,761	108,430	95,568	89,889
Total	**3,159,738**	**3,495,435**	**2,504,809**	**2,824,412**

Remark:

- *Loans and advances at 31 December 2011 included retail loan portfolios classified as assets held for sale in the audited financial statements as they were included under the Sale and Purchase Agreement with Bank of Ayudhya Public Company Limited.*
- *Loans and advances represent loans to customers and interbank and money market placements including accrued interest receivable and net of deferred income and loan impairment allowances.*
- *Investments in debt securities are measured at fair value excluding accrued interest receivable and net of any loss on impairment.*
- *Off-balance sheet represents the notional amounts before the application of a credit conversion factor.*

Table 4 : Credit risk exposure of significant on-balance sheet and off-balance sheet exposures before recognised credit risk mitigation – analysis by country or geographical area at 31 December 2011 and 2010

Exposure values are allocated to region based on the country of incorporation where the exposure was originated.

31 December 2011

	On-balance sheet				**Off-balance sheet**			
Country or geographical area	**Total THBm**	**Loans and advances THBm**	**Investments in debt securities THBm**	**Deposits THBm**	**Total THBm**	**Aval, guarantees and letter of credit THBm**	**OTC derivatives THBm**	**Undrawn commitment THBm**
Thailand	184,874	141,363	41,728	1,783	1,883,409	2,866	1,056,520	106,129
Asia Pacific (excluding Thailand)	474	464	-	10	997,077	14	1,432,128	452
North America and Latin America	184	182	-	2	173,255	29	281,709	673
Europe	448	403	-	45	441,694	10	613,729	1,176
Total	**185,980**	**142,412**	**41,728**	**1,840**	**3,495,435**	**2,919**	**3,384,086**	**108,430**

31 December 2010

	On-balance sheet				**Off-balance sheet**			
Country or geographical area	**Total THBm**	**Loans and advances THBm**	**Investments in debt securities THBm**	**Deposits THBm**	**Total THBm**	**Aval, guarantees and letter of credit THBm**	**OTC derivatives THBm**	**Undrawn commitment THBm**
Thailand	170,392	146,721	22,849	822	1,102,394	3,941	1,010,227	88,226
Asia Pacific (excluding Thailand)	220	216	-	4	1,076,639	8	1,076,128	503
North America and Latin America	215	210	-	5	161,476	3	160,549	924
Europe	312	286	-	26	483,903	-	483,667	236
Total	**171,139**	**147,433**	**22,849**	**857**	**2,824,412**	**3,952**	**2,730,571**	**89,889**

Table 5 : Credit risk exposure of significant on-balance sheet and off-balance sheet exposures before recognised credit risk mitigation – analysis by residual maturity at 31 December 2011 and 2010

	31 December 2011			31 December 2010		
	Less than 1 year THBm	Over 1 year THBm	Total THBm	Less than 1 year THBm	Over 1 year THBm	Total THBm
On-balance sheet						
Loans and advances, net	130,984	11,428	142,412	140,175	7,258	147,433
Investments in debt securities, net	27,791	13,937	41,728	16,025	6,824	22,849
Deposits (including accrued interest receivable)	1,840	-	1,840	857	-	857
Total	**160,615**	**25,365**	**185,980**	**157,057**	**14,082**	**171,139**
Off-balance sheet						
Aval, guarantees and letter of credit	2,863	56	2,919	3,930	22	3,952
OTC derivatives	1,813,757	1,570,329	3,384,086	1,310,750	1,419,821	2,730,571
Undrawn commitment	104,733	3,697	108,430	87,168	2,721	89,889
Total	**1,921,353**	**1,574,082**	**3,495,435**	**1,401,848**	**1,422,564**	**2,824,412**

Table 6 : Outstanding loans including accrued interest receivable and investments in debt securities classified as doubtful loss before recognised credit risk mitigation – analysis by country or geographical area and asset classification as prescribed by the Bank of Thailand at 31 December 2011 and 2010

	31 December 2011						
	Loans including accrued interest receivable						Investments in debt securities classified as doubtful loss
Country or geographic area	Normal THBm	Special mentioned THBm	Substandard THBm	Doubtful THBm	Doubtful loss THBm	Total THBm	THBm
Thailand	140,898	1,055	186	376	453	142,968	28
Asia Pacific (excluding Thailand)	457	12	-	-	-	469	-
North America and Latin America	173	11	-	-	-	184	-
Europe	407	-	-	-	-	407	-
Total	**141,935**	**1,078**	**186**	**376**	**453**	**144,028**	**28**

	31 December 2010						
	Loans including accrued interest receivable						Investments in debt securities classified as doubtful loss
Country or geographic area	Normal THBm	Special mentioned THBm	Substandard THBm	Doubtful THBm	Doubtful loss THBm	Total THBm	THBm
Thailand	144,941	1,969	166	448	775	148,299	69
Asia Pacific (excluding Thailand)	219	-	-	-	-	219	-
North America and Latin America	212	-	-	-	-	212	-
Europe	289	-	-	-	-	289	-
Total	**145,661**	**1,969**	**166**	**448**	**775**	**149,019**	**69**

Remark:

- *Loans at 31 December 2011 were included retail loans portfolio which classified as disposal assets held for sale in the audited financial statements as they were under the Sale and Purchase Agreement with Bank of Ayudhya Public Company Limited.*
- *Loans represent loans to customers, interbank and money market, including accrued interest receivable and net of deferred income.*
- *Investments in debt securities classified as doubtful loss represent unrealised losses on revaluation according to the definition of the BoT's Notification RE: Classification and Provision of the Financial Institutions.*
- *The classification of assets shown above is in accordance with BoT notification No. 31/2551 dated 3 August 2008 Re: Classification and Provision of the Financial Institutions.*

Table 7 : General provision, specific provision and bad debt written-off during the year against loans including accrued interest receivable and investments in debt securities – analysis by country or geographic area at 31 December 2011 and 2010

	31 December 2011			
	Loans including accrued interest receivable			**Specific provision for investments in debt securities THBm**
Country or geographic area	**General provision THBm**	**Specific provision THBm**	**Bad debt written-off during the year THBm**	
Thailand		688	611	28
Asia Pacific (excluding Thailand)		-	-	-
North America and Latin America		-	-	-
Europe		-	-	-
Total	**928**	**688**	**611**	**28**

	31 December 2010			
	Loans including accrued interest receivable			**Specific provision for investments in debt securities THBm**
Country or geographic area	**General provision THBm**	**Specific provision THBm**	**Bad debt written-off during the year THBm**	
Thailand		805	836	69
Asia Pacific (excluding Thailand)		-	-	-
North America and Latin America		-	6	-
Europe		-	-	-
Total	**781**	**805**	**842**	**69**

Remark:

- *The information for the year ended 31 December 2011 included provisions and bad debt written-off for retail loan portfolios classified as assets held for sale in the audited financial statements.*
- *The provisions for loans and advances represent only provisions against loans to customers as there were no provisions against interbank and money market transactions for the years ended 31 December 2011 and 2010.*
- *Specific provisions for investments in debt securities represent unrealised losses on the revaluation of debt securities at the year end.*

Table 8 : Outstanding loans including accrued interest receivable before recognised credit risk mitigation – analysis by type of business and asset classification as prescribed by the Bank of Thailand at 31 December 2011 and 2010

	31 December 2011					
Type of business	**Normal THBm**	**Special mentioned THBm**	**Substandard THBm**	**Doubtful THBm**	**Doubtful loss THBm**	**Total THBm**
Agriculture and mining	233	-	-	-	-	233
Financial sector	90,755	-	-	-	-	90,755
Manufacturing and commerce	25,655	251	-	364	394	26,664
Real estate business and construction	1,277	-	-	-	-	1,277
Public utilities and services	10,788	256	-	-	-	11,044
Housing loan	1,348	31	5	9	3	1,396
Others	11,879	540	181	3	56	12,659
Total	**141,935**	**1,078**	**186**	**376**	**453**	**144,028**

Type of business	31 December 2010					
	Normal THBm	**Special mentioned THBm**	**Substandard THBm**	**Doubtful THBm**	**Doubtful loss THBm**	**Total THBm**
Agriculture and mining	720	-	-	-	-	720
Financial sector	106,805	-	-	-	-	106,805
Manufacturing and commerce	18,138	1,496	-	432	722	20,788
Real estate business and construction	1,047	-	-	-	-	1,047
Public utilities and services	6,690	144	-	-	-	6,834
Housing loan	1,141	8	2	13	5	1,169
Others	11,120	321	164	3	48	11,656
Total	**145,661**	**1,969**	**166**	**448**	**775**	**149,019**

Remark: The classification of assets shown above is in accordance with BoT notification No. 31/2551 dated 3 August 2008 Re: Classification and Provision of the Financial Institutions.

Table 9 : General provision, specific provision and bad debt written-off during the year against loans including accrued interest receivable – analysis by type of business at 31 December 2011 and 2010

Type of business	31 December 2011		
	General provision THBm	**Specific provision THBm**	**Bad debt written-off during the year THBm**
Agriculture and mining		-	-
Financial sector		-	-
Manufacturing and commerce		684	42
Real estate business and construction		-	-
Public utilities and services		-	-
Housing loan		1	-
Others		3	569
Total	**928**	**688**	**611**

Type of business	31 December 2010		
	General provision THBm	**Specific provision THBm**	**Bad debt written-off during the year THBm**
Agriculture and mining		-	-
Financial sector		-	-
Manufacturing and commerce		801	-
Real estate business and construction		-	6
Public utilities and services		-	-
Housing loan		1	1
Others		3	835
Total	**781**	**805**	**842**

Remark: Bad debt written off during the year ended 31 December 2011 of Baht 567 million (2010 : Baht 834 million) is in respect of the retail portfolio.

Table 10 : Reconciliation of the movement in the general provision and specific provision against loans including accrued interest receivable at 31 December 2011 and 2010

	31 December 2011		
	General provision THBm	**Specific provision THBm**	**Total THBm**
Provisions at the beginning of year	781	805	1,586
Bad debts written-off during the year	(567)	(44)	(611)
Provisions charge (reversal) during the year	714	(73)	641
Provisions at the end of year	**928**	**688**	**1,616**

	31 December 2010		
	General provision THBm	**Specific provision THBm**	**Total THBm**
Provisions at the beginning of year	1,014	797	1,811
Bad debts written-off during the year	(834)	(8)	(842)
Provisions charge during the year	601	16	617
Provisions at the end of year	**781**	**805**	**1,586**

Remark: The above information also includes interbank and money market transactions.

Table 11 : Net exposure of on-balance sheet and credit equivalent amount of off-balance sheet before recognised credit risk mitigation classified by type of assets under the Standardised Approach at 31 December 2011 and 2010

	31 December 2011		
	On-balance sheet THBm	**Off-balance sheet THBm**	**Total THBm**
Performing claims			
Claims on sovereigns and central banks, and MDBs	35,074	73,826	108,900
Claims on financial institutions, PSEs treated as claims on financial institutions, and securities firms	405	47,811	48,216
Claims on corporate, PSEs treated as claims on corporate	40,757	19,284	60,041
Claims on retail portfolios	12,390	-	12,390
Claims on housing loans	1,376	-	1,376
Other assets	28,751	-	28,751
Non-performing claims	361	78	439
Total	**119,114**	**140,999**	**260,113**

	31 December 2010		
	On-balance sheet THBm	**Off-balance sheet THBm**	**Total THBm**
Performing claims			
Claims on sovereigns and central banks, and MDBs	29,766	94,410	124,176
Claims on financial institutions, PSEs treated as claims on financial institutions, and securities firms	2,377	42,053	44,430
Claims on corporate, PSEs treated as claims on corporate	32,488	18,844	51,332
Claims on retail portfolios	11,269	-	11,269
Claims on housing loans	1,155	-	1,155
Other assets	33,453	-	33,453
Non-performing claims	622	57	679
Total	**111,130**	**155,364**	**266,494**

Remark:

- *The above information has been presented net of specific provision.*
- *Off-balance sheet amounts have been adjusted by the credit conversion factor and also included repo style transactions.*

Ratings from External Credit Assessment Institutions

Credit risk under the Standardised Approach has been calculated based on the external credit ratings from External Credit Assessment Institutions ('ECAI'). The Bank uses external credit ratings from the following ECAIs which are approved by the BoT.

- Standard & Poor's Ratings Service;
- Moody's Investors Services;
- Fitch Ratings;
- Fitch Ratings (Thailand);
- TRIS Rating

Data files of external ratings from the nominated ECAIs are matched with the customer records in the centralized credit database.

When calculating the risk-weighted value of any exposure, risk systems identify the customer in question and look up in the central database the available rating, according to the BoT's rating selection rules as prescribed in the appendix 4 of the BoT's guideline on Minimum Capital Requirement for Credit Risk under the Standardised Approach. The system then applies the BoT's prescribed credit quality step mapping to derive from the rating the relevant risk weight.

Table 12 : Net exposure of on-balance sheet and credit equivalent amount of off-balance sheet after recognised credit risk mitigation for each type of assets, classified by risk weight under the Standardised Approach at 31 December 2011 and 2010

31 December 2011

	Net exposures after recognised credit risk mitigation – Rated					Net exposures after recognised credit risk mitigation – Unrated					
Risk weight	**0%**	**20%**	**50%**	**100%**	**150%**	**0%**	**20%**	**50%**	**35%**	**75%**	**100%**
	THBm	**THBm**	**THBm**	**THBm**	**THBm**	**THBm**	**THBm**	**THBm**	**THBm**	**THBm**	**THBm**
Performing claims											
Claims on sovereigns and central banks, and MDBs	122,065	-	576	-	-			-			-
Claims on financial institutions, PSEs treated as claims on financial institutions, and securities firms	-	29,588	692	3,898	-						-
Claims on corporate, PSEs treated as claims on corporate	-	1,123	3,671	1,360	1						48,284
Claims on retail portfolios										-	12,330
Claims on housing loans									202	-	1,174
Other assets						33,225	59				923
Risk weight			**50%**	**100%**	**150%**					**75%**	
Non-performing claims			5	64	300					-	

31 December 2010

	Net exposures after recognised credit risk mitigation – Rated					Net exposures after recognised credit risk mitigation – Unrated					
Risk weight	**0%**	**20%**	**50%**	**100%**	**150%**	**0%**	**20%**	**50%**	**35%**	**75%**	**100%**
	THBm	**THBm**	**THBm**	**THBm**	**THBm**	**THBm**	**THBm**	**THBm**	**THBm**	**THBm**	**THBm**
Performing claims											
Claims on sovereigns and central banks, and MDBs	123,656	-	520	-	-			-			-
Claims on financial institutions, PSEs treated as claims on financial institutions, and securities firms	-	30,854	1,144	3,460	-						-
Claims on corporate, PSEs treated as claims on corporate	-	268	3,935	2,004	1						42,326
Claims on retail portfolios										-	11,202
Claims on housing loans									6	-	1,149
Other assets						44,186	86				874
Risk weight			**50%**	**100%**	**150%**					**75%**	
Non-performing claims			3	232	374					-	

Remark: Off-balance sheet represents the notional amounts after applied credit conversion factor.

Credit risk mitigation

The Bank's approach when granting credit facilities is to do so on the basis of capacity to repay rather than place primary reliance on credit risk mitigation. Depending on a customer's standing and the type of product, facilities may be provided unsecured. Mitigation of credit risk is nevertheless a key aspect of effective risk management and, in a diversified financial services organisation, takes many forms.

The Bank's general policy is to promote the use of credit risk mitigation, justified by commercial prudence and good practice as well as capital efficiency. Specific, detailed policies cover the acceptability, structuring and terms of various types of business with regard to the availability of credit risk mitigation, for example in the form of collateral security. These policies, together with the determination of suitable valuation parameters, are subject to regular review to ensure that they are supported by empirical evidence and continue to fulfil their intended purpose.

The most common method of mitigating credit risk is to take collateral. In residential and commercial real estate businesses, a mortgage over the property is usually taken to help secure claims. In the commercial and industrial sectors, charges are created over business assets such as premises, stock and debtors. Facilities to small and medium enterprises are commonly granted against guarantees given by their owners and/or directors. Guarantees from third parties can arise where the Bank extends facilities without the benefit of any alternative form of security, e.g. where it issues a bid or performance bond in favour of a non-customer at the request of another bank.

In the institutional sector, trading facilities are supported by charges over financial instruments such as cash, debt securities and equities. Financial collateral in the form of marketable securities is used in much of the Bank's over-the-counter ('OTC') derivatives activities and in securities financing transactions ('SFT') such as repos, reverse repos, securities lending and borrowing. Netting is extensively used and is a prominent feature of market standard documentation.

HSBC's Global Banking and Markets business utilises credit risk mitigation to actively manage the credit risk of its portfolios, with the goal of reducing concentrations in individual names, sectors or portfolios. The techniques in use include credit default swaps, structured credit notes and securitisation structures. Buying credit protection creates credit exposure against the protection provider.

Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt of cash, securities or equities. Daily settlement limits are established to cover the aggregate of our transactions with a counterparty on any single day. Settlement risk on many transactions can be further substantially mitigated by settling through assured payment systems or on a delivery-versus-payment basis.

Policies and procedures govern the protection of our position from the outset of a customer relationship, for instance in requiring standard terms and conditions or specifically agreed documentation permitting the offset of credit balances against debt obligations and through controls over the integrity, current valuation and, if necessary, realisation of collateral security.

Valuation strategies are established to monitor collateral mitigants to ensure that they will continue to provide the anticipated secure secondary repayment source. Where collateral is subject to high volatility, valuation is frequent; where stable, less so. Market trading activities such as collateralised OTC derivative and SFT's typically carry out daily valuations in support of margining arrangements. In the residential mortgage business, Group policy prescribes re-valuation at intervals of up to three years, or more frequently as the need arises, for example where market conditions are subject to significant change. Residential property collateral values are determined through a combination of professional appraisals, market indices or statistical analysis.

For banking book exposures subject to the standardised approach – covered by eligible guarantees, non-financial collateral, or credit derivatives – the exposure is divided into covered and uncovered portions. The covered portion attracts the risk weight applicable to the credit quality step associated with the protection provider, while the uncovered portion attracts the risk weight associated with the credit quality step of the obligor. For trading book exposures fully or partially

covered by eligible financial collateral, the value of the exposure is adjusted under the Financial Collateral Comprehensive Method using supervisory volatility adjustments, including those arising from currency mismatch, which are determined by the specific type of collateral (and, in the case of eligible debt securities, their credit quality) and its liquidation period. The adjusted exposure value is subject to the risk weight associated with the credit quality step of the obligor.

Credit valuation adjustment

The credit valuation adjustment is an adjustment to the value of OTC derivative transaction contracts to reflect, within fair value, the possibility that the counterparty may default, and we may not receive the full market value of the transactions. The adjustment aims to calculate the potential loss arising from the portfolio of derivative transactions against each third party, based upon a modelled expected positive exposure profile, including allowance for credit risk mitigants such as netting agreements and Credit Support Annexes ('CSA').

Collateral arrangements

It is our policy to revalue all traded transactions and associated collateral positions on a daily basis. An independent Collateral Management function manages the collateral process, which includes pledging and receiving collateral, and investigating disputes or non-receipts.

Eligible collateral types are controlled under a policy which ensures the collateral agreed to be taken exhibits characteristics such as price transparency, price stability, liquidity, enforceability, independence, reusability and eligibility for regulatory purposes. A valuation 'haircut' policy reflects the fact that collateral may fall in value between the date the collateral was called and the date of liquidation or enforcement.

Table 13 : Exposure value under the Standardised Approach covered by collateral classified by type of assets and collateral at 31 December 2011 and 2010

	31 December 2011		**31 December 2010**	
	Eligible financial collateral THBm	**Guarantee and credit derivatives THBm**	**Eligible financial collateral THBm**	**Guarantee and credit derivatives THBm**
Performing claims				
Claims on financial institutions, PSEs treated as claims on financial institutions, and securities firms	16,541	-	11,193	-
Claims on corporate, PSEs treated as claims on corporate	3,112	2,943	643	2,220
Claims on retail portfolios	46	14	57	10
Non-performing claims	15	57	15	57
Total	**19,714**	**3,014**	**11,908**	**2,287**

Market risk

Market risk is the risk that movements in market factors, including foreign exchange rates, commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.

The Bank separates exposures to market risk into trading and non-trading portfolios. Trading portfolios include positions arising from market-making, position-taking and others designated as mark-to-market. Non-trading portfolios include positions that primarily arise from the interest rate management of the Bank's retail and commercial banking assets and liabilities, financial investments designated as available-for-sale and held-to-maturity.

We apply similar risk management policies and measurement techniques to both trading and non-trading portfolios. Our objective is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the Group's status as one of the world's largest banking and financial services organizations.

The management of market risk is principally undertaken in Global Markets using risk limits approved by the GMB. Limits are set for portfolios, products and risk types, with market liquidity being a primary factor in determining the level of limits set.

Group Risk, an independent unit, is responsible for our market risk management policies and measurement techniques. The Treasury Administration Department ('TAD'), an independent unit from Global Markets (risk taking unit), is responsible for measuring market risk exposures in accordance with the policies defined by Group Risk, and monitoring and reporting these exposures against the prescribed limits on a daily basis.

Each operating entity is required to assess the market risks arising on each product in its business and to transfer these risks to either its local Global Markets unit for management, or to separate books managed under the supervision of the local Asset and Liability Management Committee ('ALCO'). The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to manage such risks professionally.

The Bank uses a range of tools to monitor and limit market risk exposures. These include sensitivity analysis, VaR and stress testing.

Sensitivity analysis

Sensitivity measures are used to monitor the market risk positions within each risk type, for example, present value of a basis point movement in interest rates, for interest rate risk. Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

Value at risk

VaR is a technique that estimates the potential losses on risk positions in the trading portfolio as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence.

The VaR models used by the Bank are based on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates such as interest rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures.

The historical simulation models used by the Bank incorporate the following features:

- potential market movements are calculated with reference to data from the past two years;
- historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities; and
- VaR is calculated to a 99 percent confidence level and for a one-day holding period.

TAD is responsible for preparing the VaR report and submitting it to local senior management for their consideration on a daily basis. If there are exceptions, the exception report has to be sent to local senior management and also the regional market risk unit.

The Bank validates the accuracy of its VaR models by back-testing the actual daily profit and loss results, adjusted to remove non-modeled items such as fees and commissions, against the corresponding VaR numbers. The back-testing is performed by TAD on a daily

basis. Statistically, the Bank would expect to see losses in excess of VaR only 1 percent of the time over a one-year period. The actual number of excesses over this period can therefore, be used to gauge how well the models are performing.

Although a valuable guide to risk, VaR should always be viewed in the context of its limitations. For example;

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or the risk offset in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all position fully;
- the use of a 99 percent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore, does not necessarily reflect intra-day exposures; and
- VaR is unlikely to reflect loss potential on exposures that only arise under significant market moves.

Stress testing
In recognition of VaR's limitations, the Bank augments it with stress testing to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables.

We determine the scenarios to be applied at portfolio and consolidated levels, as follows:

- sensitivity scenarios consider the impact of any single risk factor or set of factors that are unlikely to be captured within the VaR models, such as the break of a currency peg;
- technical scenarios, which consider the largest move in each risk factor, without consideration of any underlying market correlation;
- hypothetical scenarios consider potential macro-economic events, for example, a global flu pandemic; and
- historical scenarios incorporate historical observations of market movements during previous periods of stress which would not be captured within VaR.

In addition to Group's stress testing scenarios, the Bank also perform the stress testing using the scenarios as specified by the BoT, covering parallel and non-parallel shifts in interest rate yield curves and depreciation and appreciation in major currencies.

Interest rate risk
Interest rate risk arises within the trading portfolios, principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments.

We aim, through our management of market risk in non-trading portfolios, to mitigate the effect of prospective interest rate movements which could reduce future net interest income, while balancing the cost of such hedging activities on the current net revenue stream.

Interest rate risk arising within the trading portfolios is measured, where practical, on a daily basis. We use a range of tools to monitor and limit interest rate risk exposures. These include the present value of a basis point movement in interest rates, VaR, stress testing and sensitivity analysis.

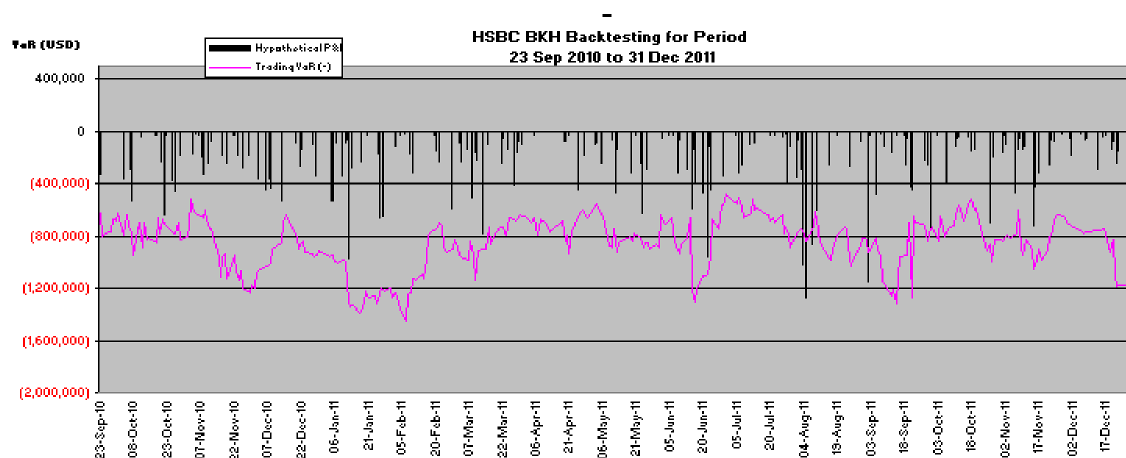
Foreign exchange risk
Foreign exchange risk arises as a result of movements in the relative value of currencies. In addition to VaR and stress testing, we control the foreign exchange risk within the trading portfolio by limiting the open exposure to individual currencies, and on an aggregate basis.

Specific issuer risk
Specific issuer (credit spread) risk arises from a change in the value of debt instruments due to a perceived change in the credit quality of the issuer or underlying assets. As well as VaR and stress testing, we manage the exposure to credit spread movements within the trading portfolios through the use of limits referenced to the sensitivity of the present value of a basis point movement in credit spreads.

Table 14 : Market risk information by Internal Model Approach at 31 December 2011, 30 June 2011 and 31 December 2010

	31 December 2011 THBm	30 June 2011 THBm	31 December 2010 THBm
Interest Rate Risk			
Maximum VaR during the period	127	124	113
Average VaR during the period	82	75	83
Minimum VaR during the period	51	45	57
VaR at the end of the period	126	45	89
Foreign Exchange Rate Risk			
Maximum VaR during the period	34	30	26
Average VaR during the period	14	15	12
Minimum VaR during the period	4	3	5
VaR at the end of the period	5	9	23
Total Market Risk			
Maximum VaR during the period	129	127	118
Average VaR during the period	83	76	81
Minimum VaR during the period	52	47	50
VaR at the end of the period	126	47	87

Table 15 : Backtesting result (considering loss side of Hypothetical P&L vs. VaR)



Remark: There were no Backtesting exceptions for the period of 23 September 2010 to 31 December 2011.

Interest rate risk in the banking book

Interest rate risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. The prospective change in future net interest income from non-trading portfolios will be reflected in the current realisable value of these positions, should they be sold or closed prior to maturity.

In order to manage this risk optimally, market risk in non-trading portfolios is transferred to Global Banking and Markets or to separate books managed under the supervision of the local Asset and Liability Management Committee.

The transfer of market risk to books managed by Global Markets or supervised by Asset and Liability Management Committees is usually achieved by a series of internal deals between the business units and these books. When the behavioural characteristics of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the true underlying interest rate risk.

Behavioural assumptions of a product are assessed with respect to each local market in which the product is offered. Local Asset and Liability Management Committees are required to regularly monitor all such behavioural assumptions and interest rate risk positions to ensure they comply with interest rate risk limits established by RMM.

The Bank aims, through its management of interest rate risk, to mitigate the effect of prospective interest rate movements which could reduce its future net interest income, balanced against the cost of associated hedging activities, on the current net revenue stream.

Interest rate risk arising within the trading portfolios and non-trading portfolios is measured, where practical, on a daily basis. HSBC uses a range of tools to monitor and limit interest rate risk exposures. These include the present value of a basis point movement in interest rates, VaR, stress testing and sensitivity analysis.

The table below sets out the effect on future net income of an incremental 100 basis points parallel rise in yield curves during the 12 months.

Table 16 : The effect of changes in interest rates to net interest income in the banking book at 31 December 2011 and 2010

Currency	Effect to net income **2011** **THBm**	 **2010** **THBm**
Baht	470	480
US Dollar	(250)	(142)
Euro	(3)	(6)
Others	(52)	(33)
Total effect of changes in interest rates to net interest income	**165**	**299**

Equity exposures in the banking book

At 31 December 2011, the Bank had equity investments in the banking book of Baht 222 million (2010: Baht 218 million). These are classified as available-for-sale for accounting purposes and held for the purposes maintained as capital fund under Section 32. There are no realised gains or losses on equity securities recognised in the statements of income during the period. Unrealised gains on revaluation of available-for-sale securities at 31 December 2011 of Baht 22 million (2010: Baht 18 million) were recognised directly in other comprehensive income.

Details of the Bank's accounting policy for available-for-sale equity investments are detailed on pages 12, of the *Annual financial statements and Audit report of Certified Public Accountant 2011*.

Table 17 : Equity exposures in the banking book at 31 December 2011 and 2010

	At 31 December	
	2011 THBm	**2010 THBm**
Equity exposures		
Book value	200	200
Fair value	222	218
Unrealised gains on revaluation of available-for-sale equities	22	18
Minimum capital requirements for equity exposures on Standardised Approach	-	1

Remark: At 31 December 2011 and 2010, the Bank holds 200,000 units of The ABF Thailand Bond Index Fund with Net Asset Value of Baht 1,109.7721 per unit and Baht 1,092.0883 per unit, respectively. It should be noted that the major component of The ABF Thailand Bond Index Fund is Government securities with a risk weight of zero.

Operational risk

Operational risk is defined as 'the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk'.

Operational risk is relevant to every aspect of our business and covers a wide spectrum of issues. Losses arising through fraud, unauthorised activities, errors, omission, inefficiency, systems failure or from external events all fall within the definition of operational risk.

Objective
The objective of our operational risk management is to manage and control operational risk in a cost-effective manner within targeted levels of operational risk consistent with the Group's risk appetite, as defined by GMB.

Organisation and responsibilities
Operational risk management is primarily the responsibility of all employees and business management. The Group Operational Risk function and the Operational Risk Management Framework ('ORMF') assist business management with discharging this responsibility. Designated Operational Risk Co-ordinators work within key business units and have responsibility for ensuring that the ORMF is effectively implemented in their assigned business units.

Measurement and monitoring
HSBC has codified its ORMF in a high level standard, supplemented by detailed policies. The detailed policies explain HSBC's approach to identifying, assessing, monitoring and controlling operational risk and give guidance on mitigating action to be taken when weaknesses are identified.

HSBC's business managers are responsible for maintaining an acceptable level of internal control, commensurate with the scale and nature of operations. They are responsible for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

Operational risk capital requirements are calculated under the Standardised Approach, as a percentage of the average of the last three financial years' gross income.

Operational risk and control assessment approach
Operational risk and control assessments are performed by individual business units and functions. The risk assessment and control assessment process is designed to provide business areas and functions with forward looking view of operational risks and an assessment of effectiveness of controls, and tracking mechanism for action plans so that they can proactively manage operational risks within acceptable levels. Risk and control assessments are review and undated at least annually.

All appropriate means of mitigation and controls are considered. These include:

- making specific changes to strengthen the internal control environment;
- investigating whether cost-effective insurance cover is available to mitigate the risk; and
- other means of protecting the Bank from loss.

Recording
HSBC uses a centralised database ('the Group Operational Risk Database') to record the results of its operational risk management processes. Operational risk and control assessments are input and maintained by business units. Business management and Operational Risk Business Co-ordinators monitor and follow up the progress of documented action plans.

Operational risk loss reporting
To ensure that operational risk losses are consistently reported and monitored at Group level, all Group companies are required to report individual losses when the net loss is expected to exceed US$10,000 and to aggregate all other operational risk losses under US$10,000. Losses are entered into the Group Operational Risk IT system and are reported to the Group Operational Risk function on a quarterly basis.

Glossary

Abbreviation	Brief description
A	
ALCO	Asset and Liability Management Committee
B	
Bank	The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch
BCBS	The Basel Committee on Banking Supervision
BoT	The Bank of Thailand
C	
CEO	Chief Executive Officer
CSA	Credit Support Annex
E	
EAD	Exposure at Default
ECAI	External Credit Assessment Institution, such as Moody's Investors Services, Standard & Poor's Ratings Service, Fitch Ratings or TRIS Rating
G	
GCRO	Group Chief Risk Officer
GMB	Group Management Board
Group	HSBC Holdings together with its subsidiary undertakings
H	
HSBC	HSBC Holdings together with its subsidiary undertakings
I	
ICAAP	Internal Capital Adequacy Assessment Process
IMM	Internal Model Method
IRB	Internal Ratings-Based
IRRBB	Interest Rate Risk in the Banking Book
ISDA	International Swaps and Derivatives Association
L	
LGD	Loss Given Default
M	
MDB	Multilateral Development Bank
O	
ORMF	Operational Risk Management Framework
OTC	Over-the-Counter
P	
PD	Probability of Default
PSE	Public Sector Entities
R	
RMC	Risk Management Committee
RMM	Risk Management Meeting of the Group Management Board
RWA	Risk-Weighted Asset
S	
SA	Standardised Approach
SFT	Securities Financing Transactions
T	
TAD	Treasury Administration Department
V	
VaR	Value at Risk

Term	Definition
A	
Available-for-sale ('AFS') financial assets	Those non-derivative financial assets that are designated as available-for-sale or are not classified as a) loans and receivables b) held-to-maturity investments or c) financial assets at fair value through profit or loss.
B	
Back-testing	A statistical technique used to monitor and assess the accuracy of a model, and how that model would have performed had it been applied in the past.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.
C	
Commercial real estate	Any real estate investment, comprising buildings or land, intended to generate a profit, either from capital gain or rental income.
Counterparty credit risk	Counterparty credit risk is the risk that the counterparty to a transaction may default before completing the satisfactory settlement of the transaction.
Credit default swap ('CDS')	A derivative contract whereby a buyer pays a fee to a seller in return for receiving a payment in the event of a defined credit event (e.g. bankruptcy, payment default on a reference asset or assets, or downgrades by a rating agency) on an underlying obligation (which may or may not be held by the buyer).
Credit quality step	A step in the Bank of Thailand credit quality assessment scale which is based on the credit ratings of ECAIs. It is used to assign risk weights under the standardised approach.
Credit risk	Risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises mainly from direct lending and trade finance, but also from products such as guarantees, derivatives and debt securities.
Credit risk mitigation	A technique to reduce the credit risk associated with an exposure by application of credit risk mitigants such as collateral, guarantees and credit protection.
Credit Support Annex ('CSA')	A legal document that regulates credit support (collateral) for OTC derivative transactions between two parties.
Credit valuation adjustment	An adjustment to the valuation of OTC derivative contracts to reflect the creditworthiness of OTC derivative counterparties.
E	
Exposure	A claim, contingent claim or position which carries a risk of financial loss.
Exposure at default ('EAD')	The amount expected to be outstanding after any credit risk mitigation, if and when the counterparty defaults. EAD reflects drawn balances as well as allowance for undrawn amounts of commitments and contingent exposures.
F	
Fair value	Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
Funding risk	A form of liquidity risk arising when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.

Term	Definition
G	
Global Markets	HSBC's treasury and capital markets services in Global Banking and Markets.
Group	HSBC Holdings together with its subsidiary undertakings.
H	
Haircut	With respect to credit risk mitigation, a downgrade adjustment to collateral value to reflect any currency or maturity mismatches between the credit risk mitigant and the underlying exposure to which it is being applied. Also a valuation adjustment to reflect any fall in value between the date the collateral was called and the date of liquidation or enforcement.
Held-to-maturity	An accounting classification for investments acquired with the intention and ability of being held until they mature.
I	
Impairment allowances	Management's best estimate of losses incurred in the loan portfolios at the balance sheet date.
Insurance risk	A risk, other than financial risk, transferred from the holder of a contract to the insurance provider. The principal insurance risk is that, over time, the combined cost of claims, administration and acquisition of the contract may exceed the aggregate amount of premiums received and investment income.
Internal Capital Adequacy Assessment Process ('ICAAP')	The Bank's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Internal Model Method ('IMM')	One of three approaches defined by Basel II to determine exposure values for counterparty credit risk.
Internal ratings-based ('IRB')	A method of calculating credit risk capital requirements using internal estimates of risk parameters.
ISDA master agreement	Standardised contract developed by ISDA used as an umbrella under which bilateral derivatives contracts are entered into.
L	
Liquidity risk	The risk that HSBC does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.
M	
Market risk	The risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices will reduce income or portfolio values.
Mark-to-market approach	One of three approaches defined by Basel II to determine exposure values for counterparty credit risk.
N	
Net interest income	The amount of interest received or receivable on assets net of interest paid or payable on liabilities.
O	
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events, including legal risk.
Over-the-counter ('OTC')	A bilateral transaction (e.g. derivatives) that is not exchange traded and that is valued using valuation models.

Term	Definition
R	
Regulatory capital	The capital which the Bank holds, determined in accordance with rules established by the Bank of Thailand.
Residual maturity	The period outstanding from the reporting date to the maturity or end date of an exposure.
Risk appetite	An assessment of the types and quantum of risks to which HSBC wishes to be exposed.
Risk-weighted assets ('RWA's)	Calculated by assigning a degree of risk expressed as a percentage (risk weight) to an exposure.
S	
Specific issuer risk	Specific issuer (credit spread) risk arises from a change in the value of debt instruments due to a perceived change in the credit quality of the issuer or underlying assets.
Standardised approach ('SA')	In relation to credit risk, a method for calculating credit risk capital requirements using ECAI ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.
V	
Value at risk ('VaR')	A measure the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.