

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches

for the year ended 31 March 2009

1 Scope of Application

The capital adequacy framework applies to The Hongkong and Shanghai Banking Corporation Limited – India Branches “The Bank”. The Bank has a subsidiary, HSBC Agency (India) Private Limited, which is consolidated in line with AS 21 and full capital deduction is taken. The Bank does not have any other group company where a pro-rata consolidation is done or any deduction is taken. The group entities in which the Bank has minority interests which are neither consolidated nor capital deducted are HSBC Professional Services (India) Private Limited and HSBC Consumer Finance (India) Private Limited. The investments in these companies are appropriately risk weighted.

(i) *Capital deficiencies in all subsidiaries not included in the consolidation*

The aggregate amount of capital in HSBC Agency (India) Private Limited not included in consolidation and deducted from capital is Rs 500 ('000).

(ii) *Banks total interest in insurance entities*

The Bank has no interests in any of the insurance entities of the group.

2 Capital Structure

In August 1999, the Bank raised a 10 year subordinated debt of Rs 2,000 million at 13.05% interest, which was fully subscribed through private placement. CRISIL assigned a rating of AAA/stable to the Subordinated debt. Based on the balance term to maturity as at 31 March 2009, Nil amount is considered as Tier II capital.

(i) *Composition of Tier 1 capital*

(from audited accounts)
Rs '000

| | As at 31 March 2009 |
|--------------------------------------|--------------------------------|
| Capital | 44,991,660 |
| Reserves | 51,871,566 |
| Innovative instruments | - |
| Other capital instruments | - |
| Amounts deducted from Tier 1 capital | (6,504,992) |
| Total Tier 1 capital | 90,358,234 |

(ii) *Tier 2 capital*

The amount of Tier 2 capital (net of deductions) is Rs 7,605,494 ('000).

(iii) *Debt capital instruments in upper Tier 2 capital*

No debt capital instruments are included in upper Tier 2 capital.

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

2 Capital Structure (Continued)

(iv) *Subordinated debt in lower Tier 2 capital*

Rs '000

| | As at 31 March 2009 |
|---|------------------------|
| Total amount outstanding | 2,000,000 |
| Of which amount raised during the current year | - |
| Amount eligible to be reckoned as capital funds | - |

(v) *Other deductions from capital*

There are no other deductions from capital.

(vi) *Total eligible capital*

The total eligible capital is Rs 97,963,728 ('000).

3 Capital Adequacy

The Bank's capital management framework is shaped by the structure, business model and strategic direction. Growth opportunities in recent years have resulted in an increasing and continuing need to focus on the effective management of risk, and commensurate capital to bear that risk. The Bank carefully assesses its growth opportunities relative to the capital available to support them, particularly in light of the economic environment and advent of Basel II.

The Bank maintains a strong discipline over capital allocation and ensuring that returns on investment cover capital costs.

(i) *Capital requirements for credit risk*

Rs '000

| | As at 31 March 2009 |
|---|------------------------|
| Portfolios subject to standardised approach | 43,945,297 |
| Securitisation exposures | - |
| Capital requirements for credit risk | 43,945,297 |

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

3 Capital Adequacy (Continued)

(ii) Capital requirements for market risk

Rs '000

| | As at 31 March 2009 |
|---|------------------------|
| Standardised Duration Approach | |
| Interest rate risk | 7,811,810 |
| Foreign exchange risk | 405,000 |
| Equity risk | 9,777 |
| Capital requirements for market risk | 8,226,587 |

(iii) Capital requirements for operational risk

The capital requirement for operational risk under the basic indicator approach is Rs 5,416,438 ('000).

(iv) Capital ratios

| | As at 31 March 2009 |
|-----------------------------------|------------------------|
| Consolidated total capital ratio | 15.31% |
| Consolidated Tier 1 capital ratio | 14.12% |

There is no significant subsidiary for which the above disclosure is required.

4 Credit risk: general disclosures for all banks

Credit Risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from direct lending and trade finance, but also from certain off-balance sheet products such as guarantees, and from the Bank's holdings of assets in the form of debt securities.

Strategy and Processes (including credit risk management policy of the Bank)

The HSBC Group Head Office "HSBC" formulates high-level risk management policies for the HSBC Group worldwide. The Bank has formulated local credit guidelines consistent with HSBC policy. The Bank's risk management policies and procedures are subject to a high degree of oversight and guidance to ensure that all types of risk are systematically identified, measured, analyzed and actively managed.

The Bank has standards, policies and procedures dedicated to the monitoring and management of credit risk, which include the following:

- Establish and maintain the large credit exposure policy. This policy delineates the bank's maximum exposures to individual customers, customer groups and other risk concentrations. Ensure compliance with lending guidelines to specified market sectors and industries. Controlling exposures to selected industries by imposing restrictions on new business, where required.

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (*Continued*)

for the year ended 31 March 2009

4 Credit risk: general disclosures for all banks (*Continued*)

- Undertake independent review and objective assessment of credit risk. All commercial non-bank credit facilities originated by the group in excess of designated limits are subject to review prior to the facilities being committed to customers.
- Control exposures to banks and other financial institutions. The Group's credit and settlement risk limits to counterparties in the finance and government sectors are designed to optimise the use of credit availability and avoid excessive risk concentration.
- Manage exposures to debt securities by establishing controls in respect of the liquidity of securities held for trading and setting issuer limits for financial investments. Separate portfolio limits are established for asset-backed securities and similar instruments.
- Control cross-border exposures to manage country and cross-border risk through the imposition of country limits with sub-limits by maturity and type of business.
- Maintain and develop HSBC's risk rating framework and systems, in order to classify exposures meaningfully and facilitate focused management of the risks involved. Rating methodologies are based upon a wide range of financial analytics together with market data-based tools, which are core inputs to the assessment of customer risk. For larger facilities, while full use is made of automated risk rating processes, the ultimate responsibility for setting risk ratings rests with the final approving executive. Risk grades are reviewed frequently and amendments, where necessary, are implemented promptly.

Structure and Organization

Credit approval authorities are delegated from the Chief Credit Officer at the Regional Head Office in Hong Kong to the Chief Executive Officer, India. The Head of Credit Risk Management in India maintains a strong functional reporting line to the Chief Credit Officer in Hong Kong.

The Credit Risk Management function is responsible for the quality and performance of its credit portfolios and for monitoring and controlling all credit risks in its portfolios, including those subject to approval by the Regional Head Office in Hong Kong.

Scope and nature of risk reporting and measurement

Manage and direct credit risk management systems initiatives. HSBC has constructed a centralized database covering substantially all the Group's direct lending exposures, to deliver an increasingly granular level of management reporting. An electronic credit application process for banks is operational throughout the Group and a similar corporate credit application system covers almost all Group corporate business by value.

Maintain regular reporting on credit risk portfolio, to include information on large credit exposures, concentrations, industry exposures, levels of impairment provisioning and country exposures.

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

4 Credit risk: general disclosures for all banks (Continued)

Non performing advances

Non performing advances are identified by regular appraisals of the portfolio by management or in accordance with RBI guidelines, whichever is earlier, and specific provision is made on a case by case basis based on management's assessment of impairment of the advance, subject to the minimum provisioning levels prescribed by the RBI. Special attention is paid to problem exposures, which are subject to more frequent and intensive review and reporting, in order to accelerate remedial action. The bank engages with customers closely to work out of distress situations. Where there is no longer any realistic prospect of recovery, the outstanding advance is written off.

Subject to the minimum provisioning levels prescribed by the RBI, provision on homogenous loans relating to retail business is assessed on a portfolio basis using the historical loss and net flow methodologies.

(i) Total gross credit risk exposures

| | | | <i>Rs '000</i> |
|--|-------------------------------------|---|----------------------------|
| | | | As at 31 March 2009 |
| | Fund based ^{Note 1} | Non fund based ^{Note 2} | Total |
| | 443,920,006 | 518,979,530 | 962,899,536 |

Note 1: Amount represents funded exposure before credit risk mitigants.

Note 2: Amount represents non-funded exposure after applying credit conversion factor and before credit risk mitigants.

(ii) Geographical distribution of exposures

| | | | <i>Rs '000</i> |
|--------------|--------------------|-----------------------|----------------------------|
| | | | As at 31 March 2009 |
| | Fund based | Non fund based | Total |
| Overseas | - | - | - |
| Domestic | 443,920,006 | 518,979,530 | 962,899,536 |
| Total | 443,920,006 | 518,979,530 | 962,899,536 |

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

4 Credit risk: general disclosures for all banks (Continued)

(iii) Industry type distribution of exposures

Rs '000

| Industry | Fund based | Non fund based | Total |
|---|--------------------|--------------------|--------------------|
| Coal | - | 231,442 | 231,442 |
| Mining | 1,441,435 | 199,427 | 1,640,862 |
| Iron & Steel | 3,008,503 | 4,379,145 | 7,387,648 |
| Other Metals & Metal Products | 7,279,878 | 6,886,019 | 14,165,897 |
| Electricity (Gen & Trans.) | 539,400 | 193,691 | 733,091 |
| Cotton Textiles | 711,675 | - | 711,675 |
| Jute Textiles | - | - | - |
| Other Textiles | 8,367,053 | 5,903,589 | 14,270,642 |
| Sugar | 30,000 | 131,007 | 161,007 |
| Tea | 330,854 | 32,271 | 363,125 |
| Food Processing | 3,432,702 | 488,607 | 3,921,309 |
| Vegetable Oils (including Vanaspati) | 920,588 | 617,348 | 1,537,936 |
| Tobacco & Tobacco Products | 3,268,287 | 176,889 | 3,445,176 |
| Paper & Paper Products | 2,837,585 | 1,441,878 | 4,279,463 |
| Rubber & Rubber Products | 681,218 | 204,985 | 886,203 |
| Chemicals, Engineering and infrastructure | 40,991,797 | 76,205,375 | 117,197,172 |
| Cement | 1,620,000 | 66,200 | 1,686,200 |
| Leather and Leather Products | 779,911 | 130,885 | 910,796 |
| Gems and Jewellery | 1,448,352 | 4,037,183 | 5,485,535 |
| Construction | 14,021,944 | 3,115,445 | 17,137,389 |
| Petroleum | 39,536 | 4,955,002 | 4,994,538 |
| Automobiles including trucks | 6,011,341 | 8,497,275 | 14,508,616 |
| Computer Software | 12,354,565 | 5,546,976 | 17,901,541 |
| Other Industries | 88,311,601 | 125,719,388 | 214,030,989 |
| NBFCs & Trading | 14,771,700 | 1,650,545 | 16,422,245 |
| Banking and Finance | 116,390,239 | 264,497,047 | 380,887,286 |
| Retail Advance | 114,329,842 | 3,671,911 | 118,001,753 |
| Total | 443,920,006 | 518,979,530 | 962,899,536 |

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

4 Credit risk: general disclosures for all banks (Continued)

(iv) Residual contractual maturity breakdown of total assets

Rs '000

| | As at 31 March 2009 |
|-------------------------------|------------------------|
| 1 day | 68,553,458 |
| 2 to 7 days | 33,554,607 |
| 8 to 14 days | 13,810,073 |
| 15 to 28 days | 28,853,350 |
| 29 days & upto 3 months | 106,987,438 |
| Over 3 months & upto 6 months | 103,213,728 |
| Over 6 months & upto 1 year | 125,533,791 |
| Over 1 year & upto 3 years | 180,551,053 |
| Over 3 years & upto 5 years | 182,357,994 |
| Over 5 years | 102,788,374 |
| Total | 946,203,866 |

(v) Amount of NPAs (Gross)

Rs '000

| | As at 31 March 2009 |
|--------------|------------------------|
| Substandard | 12,683,057 |
| Doubtful 1 | 1,171,775 |
| Doubtful 2 | 582,869 |
| Doubtful 3 | 398,615 |
| Loss | 564,326 |
| Total | 15,400,642 |

(vi) Net NPA:

The net NPA is Rs 3,910,344 ('000)

(vii) NPA ratios

| | As at 31 March 2009 |
|------------------------------|------------------------|
| Gross NPAs to gross advances | 5.36% |
| Net NPAs to net advances | 1.42% |

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

4 Credit risk: general disclosures for all banks (Continued)

(viii) *Movement of NPAs*

(from audited accounts)
Rs '000

| | For the year ended 31 March 2009 | | | |
|---|---|------------------|---------------------------------|------------------|
| | Gross NPA's | Provision | Interest in Suspense | Net NPA |
| Opening balance | 6,971,493 | 4,077,106 | 1,146,683 | 1,747,704 |
| Additions | 23,800,569 | 7,620,118 | 2,329,855 | 13,850,596 |
| Reductions (including write back/write off of excess provisions) | (15,371,420) | (2,446,124) | (1,237,340) | (11,687,956) |
| Closing balance | 15,400,642 | 9,251,100 | 2,239,198 | 3,910,344 |

(ix) *Non performing investments*

The Non-performing non-SLR investment as at 31 March 2009 is Nil.

(x) *Movement of provisions for depreciation on investments*

(from audited accounts)
Rs '000

| | For the year ended 31 March 2009 |
|-----------------------------------|---|
| Opening balance | 4,182,698 |
| Provisions made during the period | - |
| Write Off | - |
| Write back of excess provisions | (774,721) |
| Closing balance | 3,407,977 |

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

5 Credit risk: disclosures for portfolios under the standardised approach

The Bank uses the following External Credit Assessment Institutions (ECAIs) approved by RBI to calculate its capital adequacy requirements under the standardised approach to credit risk

Domestic ECAIs for external ratings of Indian Corporates:

- a) Credit Analysis and Research Limited;
- b) CRISIL Limited;
- c) FITCH India; and
- d) ICRA Limited.

The Bank has used the issue-specific ratings (for both Long Term and Short Term facilities) of all the above domestic ECAIs to risk weight both funded as well as non-funded exposures on corporate customers.

The process used by the Bank to transfer public issue ratings onto comparable assets in the banking book is in line with the provisions advised in Reserve Bank of India's Prudential Guidelines on Capital Adequacy and Market Discipline issued on 27th April 2007.

The mapping of external credit ratings and risk weights for corporate exposures are provided in the grids below:

Risk weight mapping of long term corporate ratings

| Long term ratings | Risk weights |
|-------------------|--------------|
| AAA | 20% |
| AA | 30% |
| A | 50% |
| BBB | 100% |
| BB & Below | 150% |
| Unrated | 100% |

Risk weight mapping of short term corporate ratings

| CARE | Short Term Ratings | | | Risk weights |
|-----------|--------------------|---------|---------|--------------|
| | CRISIL | FITCH | ICRA | |
| PR1+ | P1+ | F1+ | A1+ | 20% |
| PR1 | P1 | F1 | A1 | 30% |
| PR2 | P2 | F2 | A2 | 50% |
| PR3 | P3 | F3 | A3 | 100% |
| PR4 & PR5 | P4 & P5 | B, C, D | A4 & A5 | 150% |
| Unrated | Unrated | Unrated | Unrated | 100% |

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

5 Credit risk: disclosures for portfolios under the standardised approach (Continued)

The claims on banks incorporated in India and foreign banks branches in India, excluding investment in equity shares and other instruments eligible for capital status are risk weighted as under:

| CRAR % | Scheduled Banks | Other Banks |
|----------|-----------------|-------------|
| > 9 | 20% | 100% |
| 6 to < 9 | 50% | 150% |
| 3 to < 6 | 100% | 250% |
| 0 < 3 | 150% | 350% |
| Negative | 625% | 625% |

International ECAs for external ratings of Foreign Banks, Foreign Sovereigns, Foreign Public Sector Entities and Non-Resident Corporates:

- Fitch
- Moodys
- Standard & Poor's

The process used by the Bank to transfer public issue ratings onto comparable assets in the banking book is in line with the provisions advised in Reserve Bank of India's Guidelines.

The mapping of external credit ratings and risk weights for the above entities are provided in the grids below:

Risk weight mapping of foreign banks

| | | | | | | |
|----------------------------------|-----------|-----|-----|---------|---------|---------|
| S&P and Fitch ratings | AAA to AA | A | BBB | BB to B | Below B | Unrated |
| Moody's rating | Aaa to Aa | A | Baa | Ba to B | Below B | Unrated |
| Risk weight | 20% | 50% | 50% | 100% | 150% | 50% |

Risk weight mapping of foreign sovereigns

| | | | | | | |
|----------------------------------|-----------|-----|-----|---------|---------|---------|
| S&P and Fitch ratings | AAA to AA | A | BBB | BB to B | Below B | Unrated |
| Moody's rating | Aaa to Aa | A | Baa | Ba to B | Below B | Unrated |
| Risk weight | 0% | 20% | 50% | 100% | 150% | 100% |

Risk weight mapping of foreign public sector entities

| | | | | | |
|----------------------------------|-----------|-----|-----------|----------|---------|
| S&P and Fitch ratings | AAA to AA | A | BBB | Below BB | Unrated |
| Moody's rating | Aaa to Aa | A | Baa to Ba | Below Ba | Unrated |
| Risk weight | 20% | 50% | 100% | 150% | 100% |

Risk weight mapping of non resident corporates

| | | | | | |
|----------------------------------|-----------|-----|-----------|----------|---------|
| S&P and Fitch ratings | AAA to AA | A | BBB | Below BB | Unrated |
| Moody's rating | Aaa to Aa | A | Baa to Ba | Below Ba | Unrated |
| Risk weight | 20% | 50% | 100% | 150% | 100% |

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

5 Credit risk: disclosures for portfolios under the standardised approach (Continued)

(i) Amount outstanding under various risk buckets (post CRM)

Rs '000

| | As at 31 March 2009 |
|--|--------------------------------|
| Below 100% risk weight | 620,528,358 |
| 100% risk weight | 229,907,938 |
| Above 100% risk weight | 88,628,764 |
| Deductions* | (6,535,229) |
| Total | 932,529,831 |
| * Deduction represents amounts deducted from Capital Funds | |

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (*Continued*)

for the year ended 31 March 2009

6 Credit risk mitigation: disclosures for standardised approaches

Policy for Collateral Valuation and Management

It is the Bank's policy that all corporate and institutional facilities be reviewed (and hence revalued) at least on an annual basis. All deeds of ownership/titles related to collateral are held in physical custody under control of executives independent of the business.

For mortgages, the credit policy clearly outlines the acceptable Loan to value (LVR) ratios for different types of properties. The maximum LVR offered to customers cannot exceed 90% of the mortgaged property, except if approved under a special lending authority. The valuation of the property is initiated through a bank-empanelled valuer who is an expert on the subject matter. Additionally, for loans exceeding INR 5 million, dual valuations are also initiated in order to have the benefit of a second opinion on the mortgaged property. The disbursal of the loan is handled through an empanelled lawyer who in exchange collects the security documents from the borrower. The property documents thus collected are attached to the credit file & sent to central archives where the same is stored in a secure manner.

In the absence of an all India property price index, it is a challenge to benchmark & update the marked to market valuations of the properties financed by the bank on an ongoing basis. However, should a loan become NPA, a fresh valuation is initiated through the bank empanelled valuer & the provisions applicable are calculated accordingly.

Main Types of Collaterals taken by HSBC

The main types of recognised collateral taken by the Bank appear in the list of eligible financial collaterals advised in Section 7.3.5 of RBI's Prudential Guidelines on Capital Adequacy and Market Discipline, and include (but not limited to) Cash on deposits, Equities listed in a main index and/or a recognised exchange, units or shares in collective investment schemes and various recognised debt securities.

Further the main types of recognised collateral taken by the Bank for mortgages include plot of land, ready & under construction properties.

Main Types of Guarantor Counterparty and their Creditworthiness

As stated in Section 7.5 of the RBI's Prudential Guidelines on Capital Adequacy and Market Discipline, certain guarantees are recognised for credit risk mitigation purposes. The main types of guarantees are from sovereigns, corporate and banks. With corporate guarantees, in order for it to be recognised as a credit risk mitigant, it must have a credit rating of AA- or above by Standard & Poor's, Fitch and Moody's.

Information about (Market or Credit) Risk Concentrations within the mitigation taken

The quantum of the credit portfolio which benefits from financial collaterals and/or guarantees as credit risk mitigants is an insignificant portion of our customer advances. Therefore the credit and/or market concentration risks are not material

(i) *Eligible financial collateral*

The total exposure (including non-funded post CCF) that is covered by eligible financial collateral, after the application of haircuts is Rs 54,633,949 ('000).

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (*Continued*)

for the year ended 31 March 2009

7 Securitisation: disclosure for standardised approach

Where the Bank securitises corporate and retail loans it has originated, these are done by selling them to a Special Purpose Vehicle (SPV), mainly in order to diversify its sources of funding. The Bank has no investment in securities issued by any SPV. In case the loan is derecognised from the books, no capital needs to be maintained. However the Bank is required to make appropriate reduction from capital for any credit enhancements provided in line with the RBI guidelines.

Corporate loan securitisations

The Bank primarily conducts securitisation activity related to corporate loan assets on a single name basis. In such transactions, the Bank sells all rights, titles and benefits in a single corporate loan to SPVs for cash, and the SPVs in turn issues pass through certificates (PTC) to investors. The loan is sold on an outright basis and with the entire credit risk of the underlying obligation transferred to the SPVs and in turn to the investors of the PTC. Upon the sale of the loan assets, the Bank does not provide any credit enhancement nor does it service the asset.

Retail loan securitisations

In retail loan securitisation transactions, the Bank sells all rights, titles and benefits in the identified portfolio of retail loans to the SPVs for cash, and the SPVs in turn issues pass through certificates to investors. Credit enhancements are used to obtain investment grade ratings on the debt issued by the SPVs. Other than the credit enhancement provided the Bank transfers the entire credit risk to the SPVs and in turn to the investors of the PTC. The Bank continues to service the retail assets securitised.

Key accounting Policies

Securitisation transactions are accounted for in accordance with the RBI guidelines on “Securitisation of Standard Assets” and Guidance Note on Accounting for Securitisation issued by the ICAI.

Securitized assets are derecognised upon sale if the Bank surrenders control over the contractual rights that comprise the financial asset. In respect of credit enhancements provided or recourse obligations accepted by the Bank, appropriate provision / disclosure is made at the time of sale in accordance with AS 29 – ‘Provisions, contingent liabilities and contingent assets’.

Gain on securitization, being the excess of the consideration received over book value of the loans and provisions against expected costs including servicing costs and expected delinquencies is amortised over the life of the securities issued by the SPV. Losses are recognised immediately.

Sales and transfers that do not meet the criteria for surrender of control are accounted for as secured borrowings.

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

7 Securitisation: disclosure for standardised approach (Continued)

ECAI's used

The Bank uses one of the following ECAIs for all types of securitisation deals:

- a) CRISIL Limited;
- b) FITCH India; and
- c) ICRA Limited.

(i) Details of securitisation of standard assets

| | <i>Rs '000</i> | |
|--|-------------------------|----------------------------|
| | Retail Loans | Corporate Loans |
| Total number of loan assets securitized | - | 34 |
| Total book value of loan assets securitised (Rs '000) | - | 45,139,705 |
| Sale consideration received for the securitised assets (Rs '000) | - | 45,339,832 |
| Gain on sale on account of securitisation (Rs '000) (1) | - | 200,127 |
| Gain on securitisation recognised in Income Statement (Rs '000) | 6,095 | 169,918 |
| The unamortized gain as at 31 March 2009 (Rs '000) | 13,068 | 154,037 |
| Form and quantum (outstanding value) of services provided by way of Credit Enhancement (Rs '000) | 40,025 | - |

Notes:

1. The gain on sale on account of securitisation for corporate loans represents the difference between the sale consideration and the book value. The gain on sale on account of securitisation on retail loans represents the discounted value of the excess interest strip retained by the Bank.

(ii) Securitisation of impaired/past due assets

The Bank has not securitized any impaired/past due assets.

(iii) Loss recognised on securitisation of assets

The Bank has not recognised any losses during the current period for any securitisation deal.

(iv) Securitisation exposures retained or purchased

The Bank has not purchased any securitisation exposures nor does it have any retained securitisation exposure.

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (*Continued*)

for the year ended 31 March 2009

8 Market risk in trading book

The objective of HSBC's market risk management 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.

Market risk is the risk that movements in foreign exchange rates, interest rates, or equity prices will result in profits or losses to the Bank. Market risk arises on financial instruments, which are measured at fair value in the trading book. It also arises on instruments carried at amortized cost but in the banking books. The objective of market risk management is to control market risk exposures to achieve an optimal return while maintaining risk at acceptable levels.

Strategy and processes :

The Bank separates exposures to market risk into trading and non-trading portfolios. Trading portfolios include those positions arising from market-making, proprietary position taking and other marked-to-market positions so designated.

Non-trading portfolios (included in the banking book) include positions that 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.

The risk components apply equally to cash and to derivative instruments. All open market risk is subject to approved limits. Limits are established to control the level of market risk and are complementary to counterparty and credit limits.

The existence of a market risk trading limit does not confer any credit, counterparty, country or sovereign risk limit: they must be separately established through normal credit procedures.

The level of market risk limits set for each operation depends upon: the size, financial and capital resources of the business, the business plan, the experience and track record of the management, dealers and market environment as well as Group's appetite.

Market risk limits are reviewed annually.

Structure and Organization of management of risk

The Bank has an independent market risk management and control function within the treasury middle office, which is responsible for measuring market risk exposures in accordance with prescribed policies, and monitoring and reporting these exposures against the approved limits on a daily basis. The monitoring of the risks is against limits assigned to the Treasurer by the Chief Executive Officer (CEO). The Treasurer allocates limits down to desks by risk type (Interest Rate and FX).

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

8 Market risk in trading book (Continued)

Scope and nature of risk measurement, risk reporting and risk monitoring systems

Market risk in trading portfolios is monitored and controlled using a complementary set of techniques. These include Value at Risk “VAR” and, for interest rate risk, present value of a basis point (PVBP) movement in interest rates, net open positions for Foreign Exchange, vega limits for options, together with stress and sensitivity testing and concentration limits. These techniques quantify the impact on capital of defined market movements.

Value at Risk “VAR” is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. VAR limits are also set for the Trading and Banking portfolios, although no separate limits are assigned for derivatives. The Bank calculates VAR using the historical simulation methodology over last two years’ market data and at 99% confidence level over a one-day holding period.

PVBP limits are set for the Bank for the Trading and Banking book. The Bank does not operate in gold, commodity or equity markets (except for certain strategic investments). Limits are set in terms of face value and/or tenor.

Stress limits/Disaster Limits are also set which, measure the sensitivity of the book to significant combined moves in the underlying interest rate/volatility/exchange rates. Limits are also set on FX Vega for the Fx Options portfolio. Daily and monthly stop loss limits are also set and monitored.

The limit structure facilitates the risk management of the individual market risks by setting limits for these risk types individually, via option scenario matrices and via appropriate stress scenarios, and the management of market risk on an overall basis by setting Value at Risk limits. These limits are established to control the level of market risk and are complementary to counterparty and credit limits.

(i) Capital requirements for market risk

Rs ‘000

| | As at 31 March 2009 |
|-----------------------|------------------------|
| Interest rate risk | 7,811,810 |
| Foreign exchange risk | 405,000 |
| Equity position risk | 9,777 |
| Total | <u>8,226,587</u> |

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (*Continued*)

for the year ended 31 March 2009

9 Interest rate risk in the banking book (IRRBB)

The banking book is defined as:

- i) Investments held in the Available for Sale (AFS) portfolio.
- ii) Risks transferred to treasury's books by the bank via the Funds Transfer Pricing (FTP) mechanism.
- iii) Funding transactions to manage the liquidity of the bank.

Market risk in non trading portfolio (banking book) arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes.

Analysis of this risk incorporates assumptions on optionality in certain product areas, for example, mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand, for example, current accounts.

Strategy and Process

In order to manage this risk optimally, market risk in banking book is transferred to separate book managed under the supervision of the Treasurer

The transfer of market risk to the AFS books 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. Local Asset and Liability Committee ("ALCO") regularly monitor all such behavioural assumptions and interest rate risk positions, to ensure they comply with interest rate risk limits.

As noted above, in certain cases, the non-linear characteristics of products cannot be adequately captured by the risk transfer process. For example, both the flow from customer deposit accounts to alternative investment products and the precise prepayment speeds of mortgages will vary at different interest rate levels. In such circumstances, simulation modelling is used to identify the impact of varying scenarios on valuations and net interest income.

Once market risk has been consolidated in ALCO-managed books, the net exposure is typically managed through the use of interest rate swaps within agreed limits.

Structure and Organisation

The Bank has an independent market risk management and control function within the treasury mid office, which is responsible for measuring interest rate risk exposures in accordance with prescribed policies, monitoring and reporting these exposures against the approved limits on a daily basis.

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

9 Interest rate risk in the banking book (IRRBB) (Continued)

Scope/Nature of Risk reporting/measurement system and mitigation techniques

The Bank monitors the sensitivity of projected net interest income under varying interest rate scenarios. The Bank manages the market risk in banking book, to mitigate the impact of prospective interest rate movements which could reduce future net interest income, whilst balancing the cost of such hedging activities on the current net revenue stream.

The Bank manages the interest rate risk arising from commercial banking activities in order to maximise yield, without exposing the bank to undue risk arising from movements in market interest rates. This involves the use of cash and derivative instruments available in the interbank market, either to close or open positions, in order to achieve the above goals, through the effective expression of the Balance Sheet Management's view of future market rates and market liquidity.

(i) *Sensitivity to upward shocks*

| IRRBB: Sensitivity to upwards 100 bps movement in INR crore | | | | | By currency | |
|---|-------|-------|------|-------|-------------|--|
| Currency | INR | USD | EUR | GBP | Total | |
| Sensitivity | 90.12 | 13.09 | 0.95 | 14.85 | 119.01 | |

Note: The above does not include investments and derivatives in the banking book as these are classified as held for trading for capital calculations.

(ii) *Sensitivity to downward shocks*

| IRRBB: Sensitivity to downwards 100 bps movement in INR crore | | | | | By currency | |
|---|---------|---------|--------|---------|-------------|--|
| Currency | INR | USD | EUR | GBP | Total | |
| Sensitivity | (90.12) | (13.09) | (0.95) | (14.85) | (119.01) | |

Note: The above does not include investments and derivatives in the banking book as these are classified as held for trading for capital calculations.

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (Continued)

for the year ended 31 March 2009

9 Interest rate risk in the banking book (IRRBB) (Continued)

Impact on Earnings (NII)

Parallel Movement in Yield curve

| INR Millions | Commercial Banking | ALCO Pool | Treasury | Sub-total | Intersegment Elimination | Total (Apr-09 to Mar-10) |
|-------------------------|-------------------------------|------------------|-----------------|------------------|-------------------------------------|-------------------------------------|
| +100 Bps | (536) | (99) | 1,566 | 931 | (699) | 232 |
| -100 Bps | 536 | 99 | (1,566) | (931) | 699 | (232) |

*Ramp Movements in Yield Curve**

| INR Millions | Commercial Banking | ALCO Pool | Treasury | Sub-total | Intersegment Elimination | Total (Apr-09 to Mar-10) |
|-------------------------|-------------------------------|------------------|-----------------|------------------|-------------------------------------|-------------------------------------|
| +100 Bps | (477) | (72) | 1,091 | 542 | (437) | 105 |
| -100 Bps | 477 | 72 | (1,091) | (542) | 437 | (105) |

* rates are assumed to rise/fall in parallel by 25bps on the first day of each quarter.

Note: The earnings risk analysis is based on the management's internal method to assess risk on earnings to interest rate movements over the next one year and factors in certain assumptions on business growth over the next twelve months.

The Hongkong and Shanghai Banking Corporation Limited

(Incorporated in the Hong Kong SAR with limited liability)

Basel II disclosures of the India Branches (*Continued*)

for the year ended 31 March 2009

10 Operational risk

Operational risk is the risk of loss arising from fraud, unauthorised activities, error, omission, inefficiency, systems failure or external events. It is inherent in every business organisation and covers a wide spectrum of issues.

Strategy and Process

The Bank manages this risk within a controls based environment in which processes are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by an independent programme of periodic reviews undertaken by internal audit / internal Control, and by monitoring external operational risk events, which ensure that the Bank stays in line with industry best practice and takes account of learnings from publicised operational failures within the financial services industry.

Structure and Organisation

The operational risk management responsibility is assigned to senior officials within each business operation.

The operational risk loss data is collected and reported to the Bank's senior management on a monthly basis. Aggregate operational risk losses are recorded and details of incidents above the materiality threshold of RBI are reported to the HSBC Group's Audit Committee. A consolidated summary and scorecard of the operational loss incidents affecting the key businesses is shared with the Bank's senior management every quarter through the Operational Risk Management Committee (ORMG) and significant loss events, gaps, mitigants etc are discussed.

Scope/Nature of Risk reporting/measurement system and mitigation techniques

The Bank has codified its operational risk management process by a high level standard, supplemented by more detailed formal guidance. This explains how the Bank manages operational risk by identifying, assessing, monitoring, controlling and mitigating the risk, rectifying operational risk events, and implementing any additional procedures required for compliance with RBI requirements.

Information systems are used to record the identification and assessment of operational risks and to generate appropriate, regular management reporting;

Assessments are undertaken of the operational risks facing each business and the risks inherent in its processes, activities and products. Risk assessment incorporates a regular review of identified risks to monitor significant changes