

SUPPLEMENTARY FINANCIAL INFORMATION

(Figures expressed in millions of Hong Kong dollars unless otherwise indicated)

1 Cross-border claims

Cross-border claims include receivables and loans and advances, and balances due from banks and holdings of certificates of deposit, bills, promissory notes, commercial paper and other negotiable debt instruments, as well as accrued interest and overdue interest on these assets. Claims are classified according to the location of the counterparties after taking into account the transfer of risk. For a claim guaranteed by a party situated in a country different from the counterparty, the risk will be transferred to the country of the guarantor. For a claim on the branch of a bank or other financial institution, the risk will be transferred to the country where its head office is situated. Claims on individual countries or areas, after risk transfer, amounting to 10 per cent or more of the aggregate cross-border claims are shown as follows:

	<i>Banks & other financial institutions</i>	<i>Sovereign & public sector entities</i>	<i>Other</i>	<i>Total</i>
At 30 June 2006				
Asia-Pacific excluding Hong Kong:				
• Australia	31,760	146	526	32,432
• Other	42,580	1,402	7,144	51,126
	74,340	1,548	7,670	83,558
The Americas:				
• Canada	18,902	3,628	2,775	25,305
• Other	21,351	2,602	9,029	32,982
	40,253	6,230	11,804	58,287
Western Europe:				
• United Kingdom	31,828	–	9,356	41,184
• Other	89,253	450	5,555	95,258
	121,081	450	14,911	136,442
At 30 June 2005				
Asia-Pacific excluding Hong Kong:				
• Australia	25,194	61	954	26,209
• Other	27,760	1,600	6,197	35,557
	52,954	1,661	7,151	61,766
The Americas:				
• Canada	19,011	4,599	1,571	25,181
• Other	13,396	2,601	10,882	26,879
	32,407	7,200	12,453	52,060
Western Europe:				
• United Kingdom	25,206	15	6,897	32,118
• Other	79,498	2,577	6,757	88,832
	104,704	2,592	13,654	120,950

1 Cross-border claims *(continued)*

	<i>Banks & other financial institutions</i>	<i>Sovereign & public sector entities</i>	<i>Other</i>	<i>Total</i>
At 31 December 2005				
Asia-Pacific excluding Hong Kong:				
• Australia	23,961	144	712	24,817
• Other	38,140	1,447	6,882	46,469
	62,101	1,591	7,594	71,286
The Americas:				
• Canada	16,229	3,976	1,677	21,882
• Other	13,182	2,460	10,712	26,354
	29,411	6,436	12,389	48,236
Western Europe:				
• United Kingdom	23,008	–	7,842	30,850
• Other	81,089	1,430	6,207	88,726
	104,097	1,430	14,049	119,576

2 Market risk

Market risk is the risk that foreign exchange rates, interest rates or equity and commodity prices will move and result in profits or losses for the Group. The Group's market risk arises from customer-related business and from position taking.

Market risk is managed within risk limits approved by the Board of Directors and delegated to the Treasurer who will allocate the limits to the individual traders. Risk limits are set by product and risk type with market liquidity being a principal factor in determining the level of limits set. Limits are set using a combination of risk measurement techniques, including position limits, sensitivity limits, as well as value at risk ("VAR") limits at a portfolio level.

The Group adopts the risk management policies and risk measurement techniques developed by the HSBC Group. The daily risk monitoring process measures actual risk exposures against approved limits and triggers specific action to ensure the overall market risk is managed within an acceptable level.

VAR is a technique which estimates the potential losses that could occur on risk positions taken due to movements in market rates and prices over a specified time horizon and to a given level of confidence. In line with the HSBC Group, Hang Seng's VAR calculation is predominantly based on historical simulation ("HS") effective 3 May 2005. Prior to May 2005, VAR calculation was predominantly based on variance/co-variance ("VCV"). HS uses scenarios derived from historical market rates, and takes account of the relationships between different markets and rates, for example, interest rates and foreign exchange rates. Movements in market prices are calculated by reference to market data from the last two years. The assumed holding period is one-day period reflecting the way the risk positions are managed. Aggregation of VAR from different risk types is based upon the assumption of independence between risk types. In recognition of the inherent limitations of VAR methodology, stress testing is performed to assess the impact of extreme events on market risk exposures.

2 Market risk (continued)

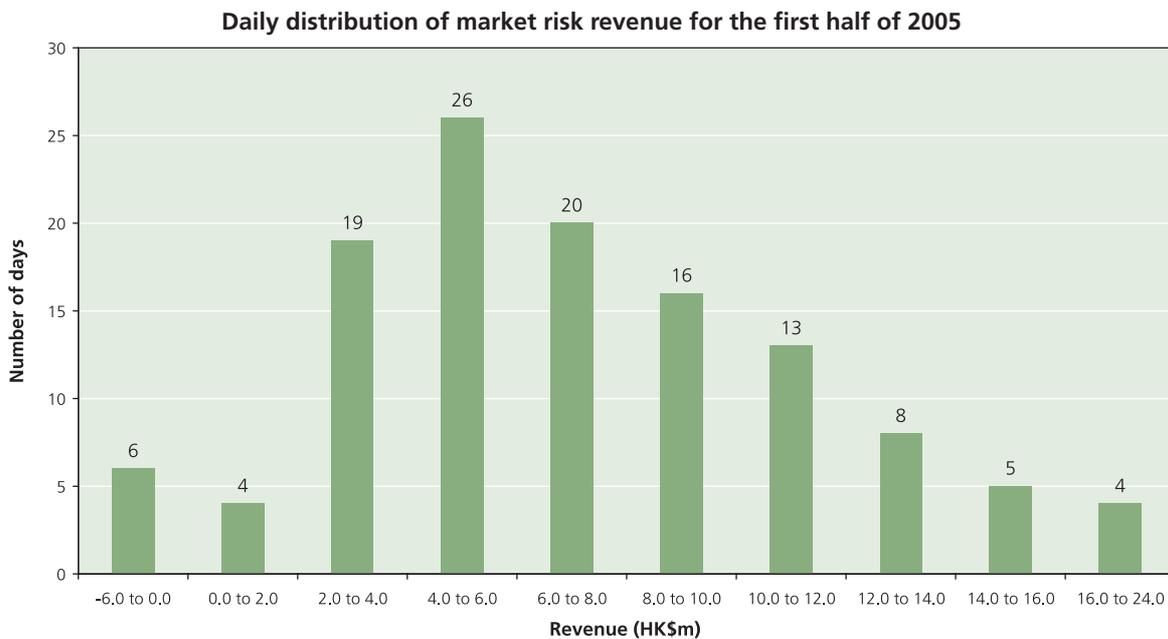
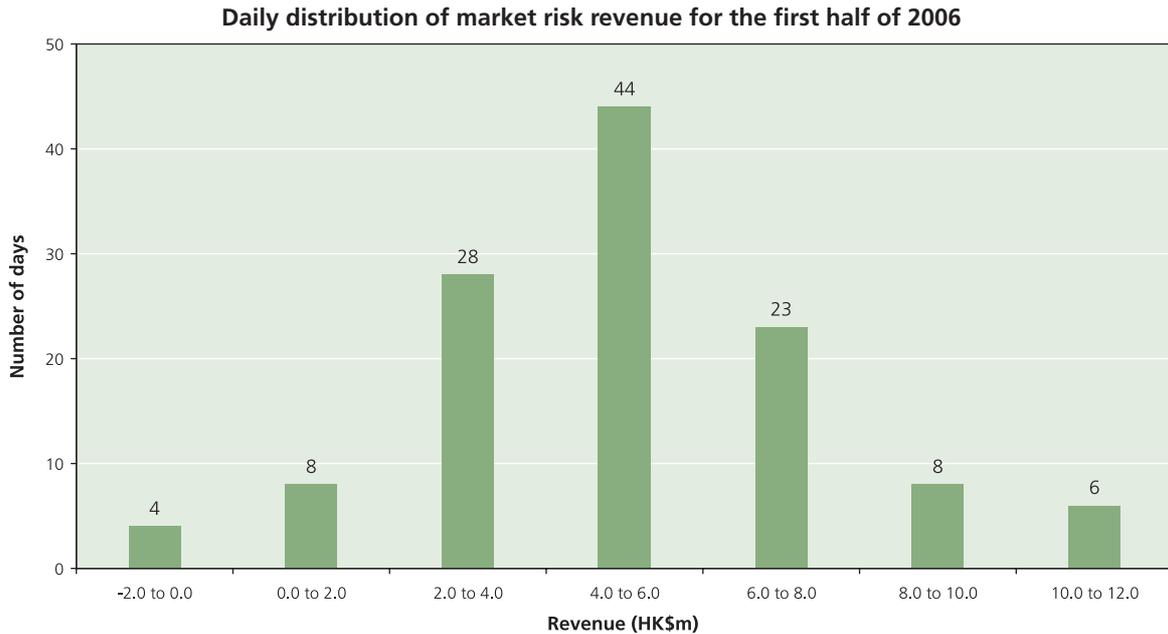
The Group's VAR for all interest rate risk and foreign exchange risk positions and on individual risk portfolios during the first halves of 2006 and 2005 are shown in the tables below. The VAR figures for the first half of 2005 are based on four months' VCV and two months' HS.

VAR

	<i>At 30 June 2006</i>	<i>Minimum during the period</i>	<i>Maximum during the period</i>	<i>Average for the period</i>
VAR for all interest rate risk and foreign exchange risk	47	47	119	86
VAR for foreign exchange risk (trading)	5	3	16	6
VAR for interest rate risk				
• trading	15	3	15	7
• non-trading	51	51	123	91
	<i>At 30 June 2005</i>	<i>Minimum during the period</i>	<i>Maximum during the period</i>	<i>Average for the period</i>
VAR for all interest rate risk and foreign exchange risk	194	123	264	205
VAR for foreign exchange risk (trading)	2	–	3	1
VAR for interest rate risk				
• trading	1	1	21	6
• non-trading	194	122	261	201

The average daily revenue earned from market risk-related treasury activities for the first half of 2006, including non-trading book net interest income and funding related to trading positions, was HK\$5 million (HK\$7 million for the first half of 2005). The standard deviation of these daily revenues was HK\$3 million (HK\$5 million for the first half of 2005). An analysis of the frequency distribution of daily revenues set out below shows that out of 121 trading days in the first half of 2006, losses were recorded on four days. Maximum daily loss was HK\$2 million for the first half of 2006 (HK\$4 million for the first half of 2005). The most frequent result was a daily revenue of between HK\$2 million and HK\$6 million, with 72 occurrences. The highest daily revenue was HK\$12 million (HK\$23 million in the first half of 2005).

2 Market risk (continued)



Interest rate risk arises in both the treasury trading and non-trading portfolios, which are managed by treasury under limits approved by the Board of Directors. The average daily revenue earned from treasury-related interest rate activities for the first half of 2006 was HK\$1 million (HK\$5 million for the first half of 2005).

The Group's foreign exchange exposures mainly comprise foreign exchange trading by treasury and currency exposures originated from its banking business. The latter are transferred to treasury where they are centrally managed within foreign exchange position limits approved by the Board of Directors. The average one-day foreign exchange profit for the first half of 2006 was HK\$4 million (HK\$2 million for the first half of 2005).

Structural foreign exchange positions arising from capital investment in subsidiaries and branches outside Hong Kong, mainly in US dollar and renminbi as set out in Note 3 to supplementary financial information, are managed by the Asset and Liability Management Committee.

3 Foreign currency positions

Foreign currency exposures include those arising from trading, non-trading and structural positions. At 30 June 2006, the US dollar (US\$) was the only currency in which the Group had a non-structural foreign currency position that exceeded 10 per cent of the total net position in all foreign currencies.

	<i>At 30 June</i> <i>2006</i>		<i>At 30 June</i> <i>2005</i>		<i>At 31 December</i> <i>2005</i>	
	<i>US\$</i>	<i>RMB</i>	<i>US\$</i>	<i>RMB</i>	<i>US\$</i>	<i>RMB</i>
Non-structural position						
Spot assets	202,537	8,960	188,701	4,665	193,149	5,955
Spot liabilities	(189,227)	(8,582)	(177,851)	(4,526)	(168,513)	(6,008)
Forward purchases	124,061	570	61,568	384	84,026	439
Forward sales	(129,724)	(827)	(71,173)	(380)	(104,960)	(300)
Net options position	25	–	(4)	–	(77)	–
Net long non-structural position	7,672	121	1,241	143	3,625	86

At 30 June 2006, the Group's major structural foreign currency positions were US dollar and renminbi.

	<i>At 30 June</i> <i>2006</i>		<i>At 30 June</i> <i>2005</i>		<i>At 31 December</i> <i>2005</i>	
	<i>% of</i> <i>total net</i> <i>structural</i> <i>position</i>		<i>% of</i> <i>total net</i> <i>structural</i> <i>position</i>		<i>% of</i> <i>total net</i> <i>structural</i> <i>position</i>	
Structural positions						
US dollar	1,133	33.0	1,037	33.0	1,035	32.5
Renminbi	2,194	63.9	1,997	63.6	2,043	64.1