Supplementary Notes to the Financial Statements (unaudited)

These notes set out on pages 243 to 268 are supplementary to and should be read in conjunction with the consolidated financial statements set out on pages 90 to 241. The consolidated financial statements and these supplementary notes taken together comply with the Banking (Disclosure) Rules (the "Disclosure Rules") made under section 60A of the Banking Ordinance.

1. BASIS OF PREPARATION

(a) Except where indicated otherwise, the financial information contained in these supplementary notes has been prepared on a consolidated basis in accordance with Hong Kong Financial Reporting Standards. Some parts of these supplementary notes, however, are required by the Disclosure Rules to be prepared on a different basis. In such cases, the Disclosure Rules require that certain information is prepared on a basis which excluded some of the subsidiaries of the Bank.

Further information regarding subsidiaries that are not included in the consolidation for regulatory purpose is set out in note 2 to the supplementary notes to the financial statements.

(b) The accounting policies applied in preparing these supplementary notes are the same as those applied in preparing the consolidated financial statements for the year ended 31 December 2009 as set out in note 4 to the financial statements.

2. CAPITAL ADEQUACY

(a) Capital adequacy ratios

The capital adequacy ratios as at 31 December 2009 are computed on the consolidated basis of the Bank and certain of its subsidiaries as specified by the HKMA for its regulatory purposes, and are in accordance with the Banking (Capital) Rules ("the Capital Rules") of the Hong Kong Banking Ordinance which became effective on 1 January 2007.

Under the Capital Rules with effective from 1 January 2007, the Group used the standardised (credit risk) approach to calculate its credit risk for non-securitisation exposures. With effective from 1 January 2008, the Group adopted the foundation internal ratings-based approach to determine credit risk. It also used the standardised (operational risk) approach to calculate its operational risk. For market risk, an internal model approach is adopted for calculating general market risk, while standardised (market risk) approach is adopted for calculating specific interest rate risk and equity risk.

From 1 January 2009, the Group has migrated to the advanced internal ratings-based approach to calculate its credit risk for the majority of its non-securitisation exposures. As a result, the numbers for 2009 and 2008 are not directly comparable. Apart from these, there are no changes in the approaches used to calculate operational risk and market risk for other risk categories. In addition, there is no relevant capital shortfall in any of the Group's subsidiaries which are not included in its consolidation group for regulatory purposes.

2. CAPITAL ADEQUACY (continued)

(a) Capital adequacy ratios (continued)

The capital base after deductions used in the calculation of capital adequacy ratios as at 31 December and reported to HKMA is analysed as follows:

	2009	2008
Capital base		
Core capital:		
– share capital	**9,559**	9,559
– retained profits	**31,708**	24,290
– classified as regulatory reserve	**(920)**	(854)
– less: deduction from core capital	**(561)**	(557)
– less: 50 per cent of total unconsolidated investments and other deductions	**(7,330)**	(6,330)
– total core capital	**32,456**	26,108
Supplementary capital:		
– fair value gains on the revaluation of property	**3,732**	3,465
– fair value gains on the revaluation of available-for-sale investment and equity	**498**	649
– collectively assessed impairment allowances	**81**	78
– regulatory reserve	**101**	94
– surplus provision	**–**	101
– term subordinated debt	**10,354**	10,357
– less: 50 per cent of total unconsolidated investments and other deductions	**(7,330)**	(6,330)
– total supplementary capital	**7,436**	8,414
Total capital base after deductions	**39,892**	34,522
Risk-weighted assets		
– credit risk	**212,434**	235,576
– market risk	**1,278**	1,684
– operational risk	**39,017**	38,104
	252,729	275,364
Capital adequacy ratio	**15.8%**	12.5%
Core capital ratio	**12.8%**	9.5%

2. CAPITAL ADEQUACY (continued)

(b) Basis of consolidation

The basis of consolidation for calculation of capital ratios under the Capital Rules follows the basis of consolidation for financial reporting with the exclusion of subsidiaries which are "regulated financial entities" (e.g. insurance and securities companies) as defined by the Capital Rules. Accordingly, the investment costs of these unconsolidated regulated financial entities are deducted from the capital base. The unconsolidated regulated financial entities are:

Hang Seng Bank (Trustee) Limited
Hang Seng Bank Trustee International Limited
Hang Seng Futures Limited
Hang Seng General Insurance (Hong Kong) Company Limited
Hang Seng Insurance Company Limited
Hang Seng Insurance (Bahamas) Limited
Hang Seng Investment Management Limited
Hang Seng Investment Services Limited
Hang Seng Life Limited
Hang Seng (Nominee) Limited
Hang Seng Securities Limited

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

3. CREDIT RISK CAPITAL REQUIREMENTS

In 2009, the Group used the advanced internal ratings-based ("IRB") approach to calculate its credit risk for the majority of its non-securitisation exposures. The remainder of its credit risk for non-securitisation exposures was assessed using the standardised (credit risk) approach. In 2008, the Group used the foundation IRB and the standardised (credit risk) approach.

The table below shows the capital requirements for credit risk for each class and subclass of exposures as specified in the Capital Rules.

3. CREDIT RISK CAPITAL REQUIREMENTS (continued)

	2009	2008
Subject to internal ratings-based approach		
Sovereign exposures	**128**	413
Bank exposures	**2,270**	4,005
Corporate exposures	**9,943**	9,477
Residential mortgages to individuals and property-holding shell companies	**663**	1,099
Qualifying revolving retail exposures	**825**	750
Small business retail exposures	**8**	12
Other retail exposures to individuals	**340**	316
Other exposures	**969**	915
Securitisation exposures	**–**	–
Equity exposures	**–**	–
Total capital requirements for credit risk under internal ratings-based approach	**15,146**	16,987
Subject to standardised (credit risk) approach		
On-balance sheet		
Sovereign exposures	**–**	–
Public sector entity exposures	**89**	43
Multilateral development bank exposures	**–**	–
Bank exposures	**–**	15
Securities firm exposures	**–**	–
Corporate exposures	**312**	397
Collective investment scheme exposures	**4**	6
Cash items	**–**	–
Regulatory retail exposures	**152**	142
Residential mortgage loans	**701**	586
Other exposures which are not past due exposures	**399**	467
Past due exposures	**48**	36
Total capital requirements for on-balance sheet exposures	**1,705**	1,692
Off-balance sheet		
Direct credit substitutes	**36**	35
Transaction-related contingencies	**2**	20
Trade-related contingencies	**6**	18
Forward asset purchases	**3**	5
Partly paid-up shares and securities	**–**	–
Forward forward deposits placed	**–**	–
Unconditionally cancellable commitments	**–**	–
Other commitments	**82**	54
Exchange rate contracts	**11**	22
Interest rate contracts	**–**	1
Equity contracts	**4**	12
OTC derivative transactions and credit derivative contracts subject to valid bilateral netting agreements	**–**	–
Other off-balance exposures which are not elsewhere specified	**–**	–
Total capital requirements for off-balance sheet exposures	**144**	167
Total capital requirements for credit risk under standardised (credit risk) approach	**1,849**	1,859
Total capital requirements for credit risk	**16,995**	18,846

The capital requirement is made by multiplying the Group's risk-weighted amount derived from the relevant calculation approach by 8 per cent. It does not reflect the Group's actual regulatory capital.

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH

(a) The internal rating system

(i) Nature of exposures within each internal-ratings based ("IRB") class

The Group adopted advanced IRB approach for the majority of its business with effect from 1 January 2009, with the remainder on standardised approach. The following exposures are subject to IRB approach:

- Corporate exposures include exposures to global large corporates, local large corporates, middle market corporates and small and medium-sized enterprises, non-bank financial institutions and specialised lending.
- Sovereign exposures include exposures to sovereign governments, central monetary institutions and government entities.
- Bank exposures include exposures to banks and regulated securities firms.
- Retail exposures include residential mortgages, qualifying revolving retail exposures, small business retail exposures and other retail exposures.
- Other exposures mainly include notes and coins, premises, plant and equipment and other fixed assets.

(ii) Structure of rating systems and control mechanisms

The Group's exposure to credit risk arises from a wide range of asset classes, customers and product types. To measure and manage the risk in these exposures, both to individually assessed customers and to those aggregated into portfolios, the Group employs diverse risk rating systems and methodologies: judgmental, analytical, and hybrids of the two. The main characteristics of the Group's credit risk rating systems are set out below.

The Group-wide credit risk rating framework incorporates probability of default ("PD") of an obligor and loss severity expressed in terms of exposures at default ("EAD") and loss given default ("LGD"). These measures are used to calculate expected loss and capital requirements. They are also used in conjunction with other inputs to form rating assessments for the purpose of credit approval and for risk management decisions.

For wholesale business (includes corporate, bank and sovereign exposures), obligor PD is estimated using a Customer Risk Rating of 22 grades, of which 20 are non-default ratings representing varying degrees of strength of financial condition, and two are default ratings. Credit score generated by a model and/or a scorecard for individual obligor is recommended to and reviewed by credit approver taking into account all relevant information to the risk rating determination.

LGD and EAD estimation for wholesale business is subject to a HSBC Group framework of basic principles with the parameter customisation based on relevant local jurisdiction. EAD is estimated to a 12-month horizon and broadly represents the current exposure plus an estimate for future draw down on undrawn facilities. LGD focuses on the facility and collateral structure which takes into account the priority/seniority of the facility, the type and value of the collateral and past experience on the type of counterparty, which is expressed as a percentage of EAD.

The Group uses supervisory slotting criteria approach in rating its regulatory specialised lending exposure. Under this approach, rating will be assigned based on the borrower and transaction characteristics.

For retail business, a wide range of application and behavioural models used in the management of retail portfolios has been supplemented to develop the credit model for measuring PD, EAD and LGD under the IRB approach. The credit risk model typically incorporates the characteristics of the products and the borrower's account behaviour. For reporting and management information purposes, retail portfolios are analysed according to analytically-derived criteria into expected loss bands, facilitating comparability across the Group's retail customer segments, business lines and product types.

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH (continued)

(a) The internal rating system (continued)

(iii) Use of internal ratings

While internal estimates derived from applying the IRB approach are employed in the calculation of risk-weighted exposure amounts for the purpose of determining regulatory capital requirements, they are also used in a multitude of contexts within risk management and business processes. Such uses continue to develop and become embedded as experience grows and the repository of quality data improves. They include:

- credit approval: authorities, including those for specific counterparty types and transactions, are delegated to officers and executives in the Group's credit risk function and business division involving lending activities using a risk-based approach, tiered relative to obligor customer risk rating;

- credit risk analytical tools: IRB measures are valuable tools deployed in the assessment of customer and portfolio risk; migration of customer risk rating becomes an important indicator in credit monitoring process;

- planning: IRB risk measures and risk weighted assets at customer segment or credit portfolio levels are considered in the Group's operating plan;

- pricing: customer relationship managers apply a risk adjusted return on capital methodology in risk-weighted assets and profitability calculators; and

- portfolio management: regular reports to Credit Committee, Risk Management Committee containing analyses of risk exposures employing IRB risk metrics, e.g. by customer segment and credit quality grade.

(iv) Credit risk mitigation

The Group's approach when granting credit facilities is to do so on the basis of capacity to repay, rather than primarily rely on credit risk mitigation. Depending on a customer's standing and the type of product, facilities may be provided on unsecured basis. Nevertheless, mitigation of credit risk is an important aspect of effective management and takes in many forms. There is immaterial credit and market risks concentrations within the credit risk mitigation held by the Group.

The Group's general policy is to promote the use of credit risk mitigation, justified by commercial prudence and good practice as well as capital efficiency. Policies covering the acceptability, structuring, control and valuation with regard to different types of collateral security are established to ensure that they are supported by evidence and continue to fulfil their intended purpose.

The main types of recognised collateral taken by the Group are those as stated in section 80 of the Capital Rules, including (but not limited to) cash on deposit, gold bullion, equities listed in a main index and/or a recognised exchange, collective investment schemes, various recognised debt securities, residential, industrial and commercial property, etc.

It is the Group's policy that all facilities of wholesale portfolios should be reviewed (and hence collateral revalued) at least on an annual basis. Where facilities have been overdue for more than 90 days and are tangibly secured, the collateral should be revalued not less than every 3 months.

For residential mortgages portfolio under retail portfolios, valuations are conducted monthly and automatically by making reference to real estate price indices. When customer has exposure larger than HK$50 million, in-house estimates or valuation from selected valuation firms is required upon annual review. For loans with serious delinquent or when the property is repossessed, an updated in-house valuation should be obtained. Where the market is subject to significant changes in conditions, revaluation should be more frequent.

The Group's policy provides that netting is only to be applied where it has the legal right to do so. Under the Capital Rules, recognised netting is defined as any netting done pursuant to a valid bilateral netting arrangement. Consistent with the Capital Rules, only bilateral netting arrangements are included for capital adequacy credit risk mitigation calculation. While the use of multi-lateral netting arrangement is allowed for internal credit risk management, it is not a valid credit risk mitigation under the Capital Rules.

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH (continued)

(a) The internal rating system (continued)

(iv) Credit risk mitigation (continued)

In terms of the application within advanced IRB approach, credit risk mitigants are considered in two broad categories: first, those which reduce the intrinsic probability of default of an obligor and therefore operate as adjustments to PD estimation, and second, those which affect estimated recoverability of obligations and require adjustment of LGD. The first includes, for example, full parental or group company guarantees; the second, collateral security of various kinds such as cash, equity, properties, fixed assets such as motor vehicles, plant and machinery, stock and debtors, bank and sovereign guarantees, etc.

The adjustment of PD estimation is also subject to supplementary methodologies in respect of a “sovereign ceiling” constraining the risk ratings assigned to obligors in countries of high risk, and of partial parental support.

For wholesale exposures, LGD estimates are determined with reference to the type and value of credit risk mitigant provided. For retail exposures, credit mitigation data is incorporated into the internal risk parameters for risk exposures and feeds continuously into the calculation of the expected loss band value summarising both customer delinquency and product or facility risk. Credit and risk mitigation data forms part of the inputs submitted to a centralised database, upon which a capital calculation engine then performs calculations by applying the relevant Basel II rules and approaches.

(v) Control mechanisms for rating systems

In order to ensure that the rating systems are robust, the Group has relevant policy and control mechanism in place to validate the accuracy and consistency of the systems, which are used for the estimation of all relevant risk components for risk management and capital adequacy calculation. Regular reporting on model performance are made to relevant management committees comprising of senior management and business representatives.

Model validation process enables the Group to reaffirm the continuing appropriateness of the models in the light of performance against expectation. The validation process involves a series of quantitative and qualitative activities to assess the rating consistency, discriminatory power, prediction power and stability of a model. The validation process covers two major aspects: pre-implementation examination and post-implementation validation.

Pre-implementation examination is performed for newly built or redeveloped risk rating models before the model is formally deployed into production environment. Pre-implementation examination is carried out by independent party not involved in the model development process. Moreover, post-implementation validation is performed periodically by the model developer with established performance benchmarking standards. There are also periodic model performance reports provided to those responsible for model oversight and model monitoring. Additionally, Internal Audit conducts annual review on model validation and monitoring processes.

(b) Internal rating process and risk components

For bank and sovereign exposures, the internal risk rating models are developed and managed centrally by the HSBC Group where the customer relationship is managed on a global basis. The assignment of customer risk rating is subject to policy stipulated by the HSBC Group to ensure consistency. Local assessment are conducted separately for the specific obligor within the global relationship group.

For corporate exposures, assessment on financial standing and repayment ability of the customer are critical in making the credit decision and in determining the customer risk ratings. The internal rating model is designed to assess the customer’s risk profile consistently and objectively. The objective assessment by the model is supplemented by lending experience and expertise of credit approvers to ensure a comprehensive assessment is made in assigning a customer risk rating. In case information external to the model is deemed to have a material impact on default probability, an override is permissible. Justification of an override is documented for independent review and model validation purposes.

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH (continued)

(b) Internal rating process and risk components (continued)

For wholesale exposures including sovereign, bank and corporate exposures, annual review of the customer's risk profile and risk rating are considered a key control point and essential credit risk management practice. In addition, credit risk policy stipulates a continuous monitoring requirement of corporate exposure by designated lending officers. Formal review and reporting is required upon any material deterioration in customer's risk profile.

For retail exposures, an homogeneous group of exposures bearing the same risk characteristics, are segmented into pools for risk rating assessment. Each exposure is assigned into a particular pool based on the assessment of the borrower and transaction risk characteristics and delinquency of exposure.

(i) Probability of default ("PD")

PD is the likelihood, expressed as a percentage, of a default event in a one-year time horizon.

The model used to estimate the PD for corporate exposure is based upon an quantitative assessment of the borrower's financials combined with a qualitative assessment of the industry environment, management experience and company structure. Based on the Group's historical default data, the score generated by the PD model is calibrated into a customer risk rating.

The model used to estimate the PD for bank exposure incorporates an advanced analytical model, which combines financial statistics and trends with qualitative inputs by the relevant relationship manager. The resultant score is blended with internal country and operating environment risk scores to generate a customer risk rating.

The model used to estimate the PD for sovereign exposure incorporates both quantitative and qualitative data from a wide range of reference sources and agencies on economic, political, financial and social conditions. Separate local currency and foreign currency risk ratings and associated PD are derived and applied to exposures denominated in the respective currencies.

The model used to estimate the PD for retail exposure takes variables of facility utilisation, payment history, account conduct as well as in-house developed application or behaviour scorecards and credit bureau data.

(ii) Exposure at default ("EAD")

EAD is a product-specific estimate of the exposure at the time of default. This calculation is based on empirical data predicting the likelihood of drawings, over a one-year time horizon, from an analysis of statistical behaviour of such default events. It is the sum of on-balance sheet balance outstanding and amount of off-balance sheet items multiplied by the credit conversion factor and the drawdown factor. Credit conversion factor is the likelihood that a non-cash/off-balance facility may crystallise and become cash exposure whereas drawdown factor is an estimate of expected additional drawdown on an available unutilised limit.

EAD models for wholesale exposures (include corporate, bank and sovereign), are developed for variable exposure products such as lines of credit, overdraft and other commitments. The models assess the likely drawdown of unconditionally cancellable and not unconditionally cancellable limits as an exposure approaches default based on the Group's historical default and drawdown experiences and supplemented by credit expert opinion where applicable.

EAD models are developed for retail revolving exposures to predict additional customer drawdown for the estimation of EAD. EAD is estimated based on current principal outstanding for non-revolving retail exposures.

(iii) Loss given default ("LGD")

LGD is an estimate of the severity of the loss that the Group is likely to incur in the event that the borrower defaults, expressed as a percentage of EAD.

LGD models for wholesale exposures are developed by assessing the recovery value of different types of collateral together with the cost in securing the recoveries and timing with which such cash flows occur. LGD for unsecured exposure is estimated based on past loss data and is driven by factors such as customer type, facility seniority and regional variances.

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH (continued)

(b) Internal rating process and risk components (continued)

(iii) Loss given default ("LGD") (continued)

LGD models for retail exposure is developed basing on the Group's internal loss and default experience including recovery values for different types of collaterals or different product natures. LGD is estimated on pools which have sufficient homogeneity and bear similar risk characteristics.

The estimation of LGD takes into consideration the impact on the value of different collaterals and recovery from unsecured exposures under economic downturn condition.

(c) Approach for determining provisions

Policies for Establishing Provisions

The impairment losses of loans and receivables are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Receivables with a short duration are not discounted if the effect of discounting is immaterial.

The total allowance for impairment losses consists of two components: individually assessed impairment allowances and collectively assessed impairment allowances. Please refer to note 4(f) to the financial statements for details of the provision policies.

All impaired loans and receivables are reviewed and analysed periodically. Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates that can be linked objectively to an event occurring after the write-down, will result in a change in the impairment allowances on loans and receivables and will be charged or credited to the profit and loss account. A reversal of impairment losses is limited to the loans and receivables' carrying amount that would have been determined had no impairment loss been recognised in prior years. Where there is no reasonable prospect of recovery, the loan and the related interest receivables are written off.

The Group takes into consideration the provision made in its capital maintenance decisions as in accordance with section 220 of the Capital Rules. The Group compares the total expected loss ("EL") amount and the total eligible provisions, and if total EL amount exceeds total eligible provisions, the Group deducts the difference from the core capital and supplementary capital. On the other hand, if total EL amount is less than the eligible provisions, the Group includes the differences in its supplementary capital up to a maximum of 0.6 per cent of the Group's risk weighted amount for credit risk calculated using IRB Approach.

(d) Exposures subject to supervisory estimates

The following table indicates the exposure classes and the respective exposure amounts that are subject to supervisory estimates as at 31 December:

	2009	2008
IRB Exposure Class		
Sovereign exposures	**–**	50,696
Bank exposures	**–**	179,639
Corporate exposures	**19,468**	188,446
Total EAD	**19,468**	418,781

Exposure as at 31 December 2009 decreased mainly due to the migration from foundation internal ratings-based approach to advances internal ratings-based approach.

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH (continued)

(e) Exposures by IRB calculation approach

The table below shows the Group's exposures:

	Advanced IRB approach	**Supervisory slotting criteria approach**	**Retail IRB approach**	**Specific risk-weight approach**	**Total exposures**
2009					
Sovereign exposures	**76,116**	**–**	**–**	**–**	**76,116**
Bank exposures	**209,757**	**–**	**–**	**–**	**209,757**
Corporate exposures	**187,790**	**19,468**	**–**	**–**	**207,258**
Retail exposures:					
– Residential mortgages to individuals and property-holding shell companies	**–**	**–**	**121,912**	**–**	**121,912**
– Qualifying revolving retail exposures	**–**	**–**	**50,321**	**–**	**50,321**
– Small business retail exposures	**–**	**–**	**3,398**	**–**	**3,398**
– Other retail exposures to individuals	**–**	**–**	**8,597**	**–**	**8,597**
Other exposures	**–**	**–**	**–**	**15,023**	**15,023**
	473,663	**19,468**	**184,228**	**15,023**	**692,382**

	Foundation IRB approach	Supervisory slotting criteria approach	Retail IRB approach	Specific risk-weight approach	Total exposures
2008					
Sovereign exposures	50,696	–	–	–	50,696
Bank exposures	179,639	–	–	–	179,639
Corporate exposures	173,412	15,034	–	–	188,446
Retail exposures:					
– Residential mortgages to individuals and property-holding shell companies	–	–	115,053	–	115,053
– Qualifying revolving retail exposures	–	–	44,309	–	44,309
– Small business retail exposures	–	–	3,119	–	3,119
– Other retail exposures to individuals	–	–	8,817	–	8,817
Other exposures	–	–	–	14,629	14,629
	403,747	15,034	171,298	14,629	604,708

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH (continued)

(f) Exposures by credit risk mitigation used

The table below shows the Group's exposures (after the effect of any on-balance sheet or off-balance sheet recognised netting) which are covered by recognised guarantees after the application of haircuts required under the Capital Rules. These exposures exclude OTC derivative transactions.

	2009	2008
Portfolio		
Bank exposures	**35,591**	31,511
Corporate exposures	**66,843**	49,161
Retail exposures	**15,722**	17,522
	118,156	98,194

For the class of sovereign exposures, there were no exposures covered by recognised guarantees.

(g) Risk assessment for exposures under IRB approach

The tables below detail the total EAD of sovereign, bank and corporate exposures by exposure-weighted average risk-weight, exposure-weighted average PD and exposure-weighted average LGD for each obligor grade as at 31 December.

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH (continued)

(g) Risk assessment for exposures under IRB approach (continued)

(i) Sovereign, bank and corporate (other than specialised lending) exposures – analysis by obligor grade

The exposure of default disclosed below in respect of sovereign, bank and corporate exposures have taken into account the effect of recognised collateral and recognised guarantees.

	Exposure-weighted average PD %	Exposure-weighted average LGD %	Exposure-weighted average risk-weight %	Exposure at default
2009				
Sovereign exposure				
Minimal risk	0.01	10.08	0.93	68,919
Low risk	0.06	44.60	13.30	7,197
				76,116
Bank exposure				
Minimal risk	0.03	23.53	5.15	55,748
Low risk	0.08	29.63	12.18	123,971
Satisfactory risk	0.24	31.75	26.97	25,212
Fair default risk	1.02	42.32	74.49	4,620
Moderate default risk	2.58	31.18	73.69	136
Significant default risk	5.07	24.56	73.18	36
High default risk	12.83	20.53	92.89	34
				209,757
Corporate exposure (other than specialised lending)				
Minimal risk	0.04	38.63	14.99	19,552
Low risk	0.10	45.00	25.58	56,105
Satisfactory risk	0.40	43.29	53.32	54,318
Fair default risk	1.22	42.79	87.93	26,202
Moderate default risk	2.99	40.86	116.44	20,468
Significant default risk	6.30	44.63	160.51	5,112
High default risk	12.74	49.13	235.09	2,431
Special management	26.51	41.82	214.06	1,364
Default	100.00	51.91	–	2,238
				187,790

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH (continued)

(g) Risk assessment for exposures under IRB approach (continued)

(i) Sovereign, bank and corporate (other than specialised lending) exposures – analysis by obligor grade (continued)

	Exposure-weighted average PD %	Exposure-weighted average risk-weight %	Exposure at default
2008			
Sovereign exposure			
Minimal risk	0.01	8.14	43,912
Low risk	0.06	22.96	6,743
Fair default risk	0.74	87.32	41
			50,696
Bank exposure			
Minimal risk	0.03	15.31	73,022
Low risk	0.08	27.03	87,035
Satisfactory risk	0.28	54.64	14,173
Fair default risk	0.82	89.85	2,352
Moderate default risk	3.56	142.93	2,850
Significant default risk	5.25	161.28	11
High default risk	11.24	211.93	36
Default	100.00	–	160
			179,639
Corporate exposure (other than specialised lending)			
Minimal risk	0.04	17.45	31,433
Low risk	0.10	29.92	53,737
Satisfactory risk	0.40	59.48	47,971
Fair default risk	1.37	99.67	19,616
Moderate default risk	3.15	117.36	12,907
Significant default risk	6.02	141.23	3,685
High default risk	10.47	153.12	573
Special management	23.59	237.45	1,159
Default	100.00	–	2,331
			173,412

In 2008, supervisory LGD estimates were applied for the sovereign, bank and corporate exposures (other than specialised lending) when foundation internal ratings-based approach was adopted.

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH (continued)

(g) Risk assessment for exposures under IRB approach (continued)

(ii) Corporate exposures (specialised lending) – analysis by supervisory rating grade

	2009		2008	
	Exposure-weighted average risk-weight %	**Exposure at default**	Exposure-weighted average risk-weight %	Exposure at default
Obligor Grade				
Strong	**64.32**	**14,460**	65.42	11,225
Good	**91.02**	**3,488**	93.46	2,997
Satisfactory	**121.90**	**1,520**	121.90	527
Weak	**–**	**–**	265.00	285
		19,468		15,034

(iii) Retail exposures – analysis by credit quality

The table below shows a breakdown of exposures (the EAD of on-balance sheet exposures and off-balance sheet exposures) on a pool basis by credit quality classification:

	Residential mortgages	**Qualifying revolving retail exposures**	**Small business retail exposures**	**Other retail exposures**	**Total exposures**
2009					
Strong	**120,465**	**42,897**	**3,327**	**6,412**	**173,101**
Medium	**996**	**7,075**	**56**	**2,076**	**10,203**
Sub-standard	**–**	**336**	**–**	**79**	**415**
Impaired	**451**	**13**	**15**	**30**	**509**
	121,912	**50,321**	**3,398**	**8,597**	**184,228**
2008					
Strong	113,287	38,329	3,030	7,376	162,022
Medium	879	5,884	80	1,343	8,186
Sub-standard	–	82	–	65	147
Impaired	887	14	9	33	943
	115,053	44,309	3,119	8,817	171,298

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH (continued)

(g) Risk assessment for exposures under IRB approach (continued)

(iv) Undrawn commitments

The table below shows the amount of undrawn commitments and exposure-weighted average EAD for sovereign, bank and corporate exposures as at 31 December 2009:

	Undrawn commitments	**Exposure-weighted average EAD**
Sovereign exposures	**–**	**–**
Bank exposures	**803**	**303**
Corporate exposures	**81,348**	**32,029**
	82,151	**32,332**

(h) Analysis of actual loss and estimates

The table below shows the actual losses which represent the net charges (including write-offs and impairment loss allowances) made during the year.

	2009	2008
Exposure Class		
Sovereign	**–**	–
Bank	**10**	1,375
Corporate	**413**	1,109
Residential mortgage	**(59)**	(20)
Qualifying revolving retail	**463**	312
Other retail	**131**	73
	958	2,849

Actual loss in 2009 improved especially for the bank and corporate sectors. In 2008, these sectors suffered due to the financial tsunami and economic slowdown of major world economies. Overall economic conditions improved in 2009. This together with the risk containment measures adopted by the Group led to lower loss during the reporting period.

The table below shows the expected loss which is the estimated future loss over a one-year time horizon for different exposure classes under IRB approach.

	31 December 2008	31 December 2007
Exposure Class		
Sovereign	2	3
Bank	191	551
Corporate	2,141	811
Residential mortgage	231	251
Qualifying revolving retail	301	282
Other retail	107	399
	2,973	2,297

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH (continued)

(h) Analysis of actual loss and estimates (continued)

It should be noted that actual loss and expected loss are measured and calculated using different methodologies which may not be directly comparable. The limitation arises mainly from the fundamental differences in the definition of "loss" under expected loss calculation which is derived based on regulatory rules and actual loss (write-off and impairment loss allowance) which is determined based on accounting standards.

The tables below set out the comparison of the predicted risk estimates of the Group's credit risk models against actual outcomes of the wholesale and retail exposures. Comparable data for LGD and EAD estimates of previous reporting period is not applicable as foundation internal ratings-based approach was adopted for the reporting year of 2008.

(i) Wholesale exposures

Risk estimates as at 31 December 2008 against actual outcome for the year 2009

	PD		LGD		EAD	
	Actual %	Estimated %	Actual %	Estimated %	Actual %	Estimated %
Sovereign exposure	–	0.07	–	15.95	–	100.00
Bank exposure	–	0.56	76.35	30.53	100.00	99.84
Corporate exposure	1.38	4.10	46.82	45.21	72.66	83.34

Risk estimates as at 31 December 2007 against actual outcome for the year 2008

	PD	
	Actual %	Estimated %
Sovereign exposure	–	0.06
Bank exposure	0.63	0.28
Corporate exposure	2.24	3.09

The actual PD rate is measured by using the number of obligor defaulted during the reporting period whereas the estimated PD rate is the long run average default rate estimated at the beginning of the reporting period. The PD estimated by internal model is calibrated to the Group's long run default experience. Hence, actual default rate in a particular year ("point-in-time") will typically differ from the estimated PD which is the "through the cycle" estimates as economies move above or below cyclical norms.

It may take more than 1 year to complete the workout process for the wholesale exposures. This creates difficulty in calculation and comparison of actual versus predicted LGD during the reporting period. The predicted LGD is the exposure weighted average LGD as of the beginning of the reporting period whereas the actual LGD is computed using the resolved default cases accumulated in 2009 which covers cases defaulted before 2009. The actual LGD of the bank exposure represents the realised loss for obligors defaulted in 2008. The relatively high loss rate was connected with the exceptional economic condition in 2008 and was the aftermath of the financial tsunami. There was minimal losses on the bank exposure in past years as well as in 2009.

The estimated EAD% represents the ratio of total model estimated exposure values to total limits at the beginning of the reporting period. The actual EAD% is the limit weighted average % which compares the realised EAD of the defaulted and resolved cases up to 2009 against the limits 1 year prior to default.

4. CREDIT RISK UNDER THE INTERNAL-RATINGS BASED APPROACH (continued)

(h) Analysis of actual loss and estimates (continued)

(ii) Retail exposures

Risk estimates as at 31 December 2008 against actual outcome for the year 2009

	PD		LGD		EAD	
	Actual %	Estimated %	Actual %	Estimated %	Actual %	Estimated %
Retail exposures:						
– Residential mortgages to individuals and property-holding shell companies	**0.34**	**1.68**	**3.34**	**11.24**	**93.33**	**100.00**
– Qualifying revolving retail exposures	**0.70**	**0.73**	**89.56**	**86.17**	**89.35**	**85.00**
– Small business retail exposures	**0.87**	**1.43**	**0.05**	**11.48**	**92.06**	**100.00**
– Other retail exposures to individuals	**3.64**	**4.20**	**63.86**	**70.93**	**64.30**	**98.71**

Risk estimates as at 31 December 2007 against actual outcome for the year 2008

	PD	
	Actual %	Estimated %
Retail exposures:		
– Residential mortgages to individuals and property-holding shell companies	0.31	1.05
– Qualifying revolving retail exposures	0.54	0.62
– Other retail exposures to individuals	2.32	5.38

(Small business retail exposures were included in other retail exposures to individuals in 2008.)

The actual PD rate is measured in the same ways as wholesale exposure.

The actual LGD for the retail exposures takes into account the 24-months recovery period and represents the realised LGD for cases defaulted during 2007 which were recovered within 24 months after default. The predicted LGD is the exposure weighted average LGD for the defaulted cases estimated prior to default.

The estimated EAD % represents the ratio of total model estimated EAD to total limits for cases defaulted during 2009 whereas the actual EAD % compares the exposure values of the cases defaulted in 2009 at the time of default against the maximum limit 1 year prior to default.

As there may be different portfolios reported under one retail asset class, portfolios with no default since model implementation are excluded from the estimated and actual comparison of the asset class concerned to eliminate distortion.

5. CREDIT RISK UNDER THE STANDARDISED (CREDIT RISK) APPROACH

(a) Ratings from External Credit Assessment Institutions ("ECAIs")

The Group uses the following ECAIs to calculate its capital adequacy requirements under the standardised (credit risk) approach prescribed in the Capital Rules:

- Fitch Ratings
- Moody's Investors Service
- Standard & Poor's Ratings Services, and
- Rating and Investment Information, Inc.

Where exposures have been rated by the above-mentioned ECAIs, they are categorised under the following class of exposures:

- Sovereign exposures
- Public sector entity exposures
- Multilateral development bank exposures
- Bank exposures
- Securities firm exposures
- Corporate exposures
- Collective investment scheme exposures

The process used to map ECAIs issuer ratings or ECAIs issue specific ratings in the Group's banking book is consistent with those prescribed in the Capital Rules.

(b) Credit risk mitigation

The Group's policies on credit risk mitigation under standardised approach align with those under the internal ratings-based approach.

As stated in sections 98 and 99 of the Capital Rules, certain guarantees and credit derivative contracts 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 mitigants, it must have a credit rating of A– or better by Standard & Poor's Ratings Services, Fitch Ratings and Rating and Investment Information, Inc, or a credit rating of A3 or better by Moody's Investors Service. With sovereign and bank guarantees, these exposures are managed by central teams in HSBC Group Head Office in London.

There is immaterial credit and market risks concentrations within the credit risk mitigants (recognised collateral and guarantees) used by the Group.

5. CREDIT RISK UNDER THE STANDARDISED (CREDIT RISK) APPROACH (continued)

(c) Credit risk exposures under the standardised (credit risk) approach

	Total exposures*	Exposures after recognised credit risk mitigation		Risk-weighted amounts		Total risk-weighted amounts	Total exposures covered by recognised collateral	Total exposures covered by recognised guarantees or recognised credit derivative contracts
		Rated	Unrated	Rated	Unrated			
2009								
Class of exposures								
On-balance sheet								
Sovereign	–	–	2,002	–	–	–	–	–
Public sector entity	14,882	14,327	69	1,107	14	1,121	–	490
Multilateral development bank	16,094	16,094	–	–	–	–	–	–
Bank	39	–	39	–	12	12	–	–
Securities firm	–	–	–	–	–	–	–	–
Corporate	11,974	397	3,502	198	3,701	3,899	6,644	1,431
Collective investment scheme	48	–	48	–	48	48	–	–
Cash items	–	–	–	–	–	–	–	–
Regulatory retail	2,721	–	2,529	–	1,896	1,896	111	81
Residential mortgage loan	14,256	–	14,239	–	8,753	8,753	13	4
Other exposures which are not past due exposures	5,435	–	4,987	–	4,987	4,987	448	–
Past due exposures	400	–	400	–	598	598	4	–
	65,849	30,818	27,815	1,305	20,009	21,314	7,220	2,006
Off-balance sheet								
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts	2,070	129	1,602	26	1,573	1,599	339	14
OTC derivative contracts	196	3	193	1	183	184	–	–
Credit derivative contracts	–	–	–	–	–	–	–	–
Other off-balance sheet exposures not elsewhere specified	–	–	–	–	–	–	–	–
	2,266	132	1,795	27	1,756	1,783	339	14
Total	68,115	30,950	29,610	1,332	21,765	23,097	7,559	2,020
Exposures deducted from capital base	–							

* Principal amount or credit equivalent amount, as applicable, net of specific provisions.

5. CREDIT RISK UNDER THE STANDARDISED (CREDIT RISK) APPROACH (continued)

(c) Credit risk exposures under the standardised (credit risk) approach (continued)

	Total exposures*	Exposures after recognised credit risk mitigation		Risk-weighted amounts		Total risk-weighted amounts	Total exposures covered by recognised collateral	Total exposures covered by recognised guarantees or recognised credit derivative contracts
		Rated	Unrated	Rated	Unrated			
2008 Class of exposures								
On-balance sheet								
Sovereign	–	–	–	–	–	–	–	–
Public sector entity	2,702	2,706	–	541	–	541	–	–
Multilateral development bank	3,976	3,976	–	–	–	–	–	–
Bank	895	81	814	16	169	185	–	–
Securities firm	–	–	–	–	–	–	–	–
Corporate	12,859	2,853	4,027	934	4,028	4,962	5,979	–
Collective investment scheme	72	–	72	–	72	72	–	–
Cash items	–	–	–	–	–	–	–	–
Regulatory retail	2,487	–	2,371	–	1,778	1,778	116	–
Residential mortgage loan	11,889	–	11,873	–	7,331	7,331	12	4
Other exposures which are not past due exposures	6,347	–	5,844	–	5,844	5,844	503	–
Past due exposures	301	–	301	–	446	446	5	–
	41,528	9,616	25,302	1,491	19,668	21,159	6,615	4
Off-balance sheet								
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts	2,606	1,231	1,375	302	1,348	1,650	593	–
OTC derivative contracts	482	14	468	3	430	433	–	–
Credit derivative contracts	–	–	–	–	–	–	–	–
Other off-balance sheet exposures not elsewhere specified	–	–	–	–	–	–	–	–
	3,088	1,245	1,843	305	1,778	2,083	593	–
Total	44,616	10,861	27,145	1,796	21,446	23,242	7,208	4
Exposures deducted from capital base	–							

* Principal amount or credit equivalent amount, as applicable, net of specific provisions.

6. COUNTERPARTY CREDIT RISK-RELATED EXPOSURES

(a) In respect of counterparty credit risk exposures which arises from over-the-counter ("OTC") derivative transactions and repo-style transactions (referred as "relevant transaction") hereunder, credit limit to counterparty credit risk arising from the relevant transaction is assigned, monitored and reported in accordance with the Group risk methodology. The credit limit established takes into account the gross contract amount and the future potential exposure measured on the basis of 95 percentile potential worst case loss estimates for the product involved. This method of calculating credit limit applies to all counterparties.

Credit equivalent amount and risk-weighted amount of relevant transaction is determined following the regulatory capital requirements. Risk-weighted amount is calculated in accordance with the counterparty risk weighting as per internal ratings-based approach/standardised (credit risk) approach under the Capital Rules.

The policy for secured collateral on derivatives is guided by the Group's internal Best Practice Guidelines ensuring the due-diligence necessary to fully understand the effectiveness of netting and collateralisation by jurisdiction, counterparty, product and agreement type is fully assessed and that the due-diligence standards are high and consistently applied. The Group's policies for establishing provisions are discussed in note 4(f) – Loan impairment.

(b) Counterparty credit risk exposures

The following tables show the counterparty credit risk exposures under the internal-ratings based approach and standardised (credit risk) approach. There was no outstanding repo-style transactions and credit derivative contracts at 31 December 2009 (2008: Nil).

(i) Counterparty credit risk exposures under the internal-ratings based approach

	2009	2008
OTC derivative transactions:		
Gross total positive fair value which are not repo-style transactions	**4,398**	6,233
Credit equivalent amount	**10,135**	14,004
Value of recognised collateral by type:		
Debt securities	**–**	–
Others	**–**	–
	–	–
Credit equivalent amount or net credit exposures net of recognised collateral held	**10,135**	14,004
Risk-weighted amount	**1,499**	3,677
Notional amount of recognised credit derivative contracts which provide credit protection	**–**	–

(ii) Counterparty credit risk exposures under the standardised (credit risk) approach

	2009	2008
OTC derivative transactions:		
Gross total positive fair value which are not repo-style transactions	**119**	345
Credit equivalent amount	**196**	482
Value of recognised collateral by type:		
Debt securities	**–**	–
Others	**–**	–
	–	–
Credit equivalent amount or net credit exposures net of recognised collateral held	**196**	482
Risk-weighted amount	**184**	433
Notional amount of recognised credit derivative contracts which provide credit protection	**–**	–

6. COUNTERPARTY CREDIT RISK-RELATED EXPOSURES (continued)

(c) Major classes of exposures by counterparty type

(i) Major classes of exposures under the internal ratings-based approach by counterparty type

	2009			2008		
	Contract amount	**Credit equivalent amount**	**Risk-weighted amount**	Contract amount	Credit equivalent amount	Risk-weighted amount
Sovereign	**–**	**–**	**–**	1,766	18	4
Public sector entities	**–**	**–**	**–**	–	–	–
Banks	**582,150**	**9,081**	**878**	763,517	12,753	3,082
Corporates	**37,478**	**1,054**	**621**	44,845	1,233	591
	619,628	**10,135**	**1,499**	810,128	14,004	3,677

(ii) Major classes of exposures under the standardised (credit risk) approach by counterparty type

	2009			2008		
	Contract amount	**Credit equivalent amount**	**Risk-weighted amount**	Contract amount	Credit equivalent amount	Risk-weighted amount
Sovereign	**–**	**–**	**–**	–	–	–
Public sector entities	**438**	**3**	**1**	1,436	15	3
Banks	**–**	**–**	**–**	–	–	–
Corporates	**3,212**	**193**	**183**	4,433	467	430
	3,650	**196**	**184**	5,869	482	433

7. ASSET SECURITISATION

There was no asset securitisation for which the Group is an originating institution or an investing institution at 31 December 2009 (2008: Nil).

8. MARKET RISK

The HKMA has granted approval under section 18(2)(a) and 18(5) of the Capital Rules for the Group to use the internal models approach to calculate its market risk for foreign exchange risk and general interest rate risk. Standardised approach is used for the calculation of specific interest rate risk, equity risk and commodity risk.

	2009	2008
Market risk calculated by:		
– Internal models approach:		
– foreign exchange exposures and general interest rate exposures	**91**	114
– Standardised approach:		
– specific interest rate exposures	**10**	20
– equity exposures	**1**	1
Total capital charge for market risk	**102**	135

9. OPERATIONAL RISK

The HKMA has granted approval under section 25(2) of the Capital Rules for the Group to use the standardised approach to calculate its operational risk.

	2009	2008
Capital charge for operational risk	**3,121**	3,048

10. EQUITY EXPOSURES IN BANKING BOOK

Investments in equity shares which are intended to be held on a continuing basis, but which do not comprise investments in associates, jointly controlled entities or subsidiaries, are classified as available-for-sale securities and are reported in the statement of financial position as “Financial investments”. Available-for-sale securities are measured at fair value as described in notes 4(g)(iii) and 4(n) on the financial statements. Included within this category are investments made by the Group for strategic purposes, which are subject to additional internal procedures and approvals to ensure that the investment is in accordance with the Group’s strategy and to ensure compliance with all relevant regulatory and legal restrictions. In some cases, additional investments may be made later such that the investee becomes an associate, jointly controlled entity or subsidiary, at which point the investment is reclassified in accordance with the Group’s accounting policies.

	2009	2008
Cumulative realised gains on disposal	**161**	255
Unrealised gains:		
– recognised in reserve but not through the income statement	**199**	254
– deducted from the supplementary capital	**–**	–

11. DISCLOSURE FOR SELECTED EXPOSURE

(a) Holding of debt securities issued by Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation

The table below shows the Group’s exposures to the senior debt securities (AAA rated) issued by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

	Gross principal	**Fair value**
At 31 December 2009	**45**	**47**
At 31 December 2008	63	66

The Group did not hold any asset-backed securities, mortgage-backed securities and collateralised debt obligations.

(b) Involvement with Special Purpose Entities (SPEs)

From time to time, the Group enters into certain transactions with customers in the ordinary course of business which involve the establishment of SPEs. The use of SPEs is not a significant part of the Group’s activities and the Group is not reliant on SPEs for any material part of its business operations or profitability.

12. ANALYSIS OF GROSS ADVANCES TO CUSTOMERS BY CATEGORIES BASED ON INTERNAL CLASSIFICATION USED BY THE GROUP

Gross advances, impaired advances, individually assessed and collectively assessed loan impairment allowances, the amount of new impairment allowances charged to income statement, and the amount of impaired loans and advances written off during the year in respect of industry sectors which constitute not less than 10 per cent of gross advances to customers are analysed as follows:

	Group					
	Gross advances	Impaired advances	Individually assessed loan impairment allowances	Collectively assessed loan impairment allowances	New impairment allowances	Advances written off during the year
2009						
Residential mortgages	**116,746**	**308**	**(5)**	**(87)**	**2**	**2**
Commercial, industrial and international trade	**61,676**	**1,615**	**(972)**	**(484)**	**520**	**384**
Commercial real estate	**31,987**	**1**	**–**	**(3)**	**–**	**–**
Other property-related lending	**63,166**	**256**	**(70)**	**(76)**	**25**	**2**
2008						
Residential mortgages	107,187	403	(33)	(104)	22	3
Commercial, industrial and international trade	62,464	2,030	(1,048)	(483)	996	101
Commercial real estate	34,354	2	–	(5)	1	–
Other property-related lending	57,979	265	(75)	(55)	85	3

13. NON-BANK MAINLAND EXPOSURES

The analysis of non-bank Mainland exposures is based on the categories of non-bank counterparties and the type of direct exposures defined by the HKMA under the Banking (Disclosure) Rules with reference to the HKMA return for non-bank Mainland exposures, which includes the Mainland exposures extended by the Bank and its overseas branches and overseas subsidiaries only.

	On-balance sheet exposure	Off-balance sheet exposure	Total exposures	Individually assessed allowances
2009				
Mainland entities	**9,241**	**1,911**	**11,152**	**–**
Companies and individuals outside Mainland where the credit is granted for use in Mainland	**6,644**	**2,653**	**9,297**	**50**
Other counterparties where the exposure is considered by the Bank to be non-bank Mainland exposure	**45**	**–**	**45**	**–**
	15,930	**4,564**	**20,494**	**50**
Exposures incurred by the Bank's mainland subsidiary	**28,038**	**10,095**	**38,133**	**183**
	43,968	**14,659**	**58,627**	**233**
2008				
Mainland entities	10,129	2,072	12,201	–
Companies and individuals outside Mainland where the credit is granted for use in Mainland	7,292	3,956	11,248	170
Other counterparties where the exposure is considered by the Bank to be non-bank Mainland exposure	15	–	15	–
	17,436	6,028	23,464	170
Exposures incurred by the Bank's mainland subsidiary	26,577	7,860	34,437	290
	44,013	13,888	57,901	460

14. 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 institutions, 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:

	Banks & other financial institutions	Public sector entities	Sovereign & other	Total
2009				
Asia-Pacific excluding Hong Kong:				
– China	**24,034**	**–**	**16,124**	**40,158**
– Japan	**8,320**	**–**	**45,952**	**54,272**
– Other	**37,436**	**589**	**8,140**	**46,165**
	69,790	**589**	**70,216**	**140,595**
The Americas:				
– United States	**39,941**	**45**	**10,259**	**50,245**
– Other	**4,762**	**694**	**13,005**	**18,461**
	44,703	**739**	**23,264**	**68,706**
Europe:				
– United Kingdom	**37,510**	**–**	**4,066**	**41,576**
– Other	**47,799**	**12,454**	**7,990**	**68,243**
	85,309	**12,454**	**12,056**	**109,819**
2008				
Asia-Pacific excluding Hong Kong:				
– China	13,539	–	11,202	24,741
– Japan	8,933	–	74,127	83,060
– Other	37,300	–	6,485	43,785
	59,772	–	91,814	151,586
The Americas:				
– United States	34,673	25	34,206	68,904
– Other	10,800	–	10,805	21,605
	45,473	25	45,011	90,509
Europe:				
– United Kingdom	36,069	–	5,825	41,894
– Other	46,939	–	6,407	53,346
	83,008	–	12,232	95,240