HSBC HOLDINGS PLC
Form 6-K
March 07, 2012
Table of Contents

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer

Pursuant to Rule 13a - 16 or 15d - 16 of

the Securities Exchange Act of 1934

For the month of March 2012

HSBC Holdings plc

42nd Floor, 8 Canada Square, London E14 5HQ, England

(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F).

Form 20-F x Form 40-F ¨

(Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934).

Yes ¨ No x

(If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-____).

Table of Contents

HSBC Holdings plc

Capital and Risk Management

Pillar 3 Disclosures

at

31 December 2011

Table of Contents

Cautionary statement regarding forward-looking statements

The *Capital and Risk Management Pillar 3 Disclosures at 31 December 2011 (Pillar 3 Disclosures 2011)* contains certain forward-looking statements with respect to HSBC s financial condition, results of operations and business.

Statements that are not historical facts, including statements about HSBC s beliefs and expectations, are forward-looking statements. Words such as expects , anticipates , intends , plans , believes , seeks , estimates , potential and reasonably possible , variations of these words and expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made. HSBC makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statements.

Written and/or oral forward-looking statements may also be made in the periodic reports to the US Securities and Exchange Commission, summary financial statements to shareholders, proxy statements, offering circulars and prospectuses, press releases and other written materials, and in oral statements made by HSBC s Directors, officers or employees to third parties, including financial analysts.

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

Certain defined terms

Unless the context requires otherwise, HSBC Holdings means HSBC Holdings plc and HSBC , the Group , we , us and our refers to HSBC Holdings together with its subsidiaries. Within this document the Hong Kong Special Administrative Region of the People s Republic of China is referred to as Hong Kong . When used in the terms shareholders equity and total shareholders equity , shareholders means holders of HSBC Holdings ordinary shares and those preference shares classified as equity. The abbreviations US$m and US$bn represent millions and billions (thousands of millions) of US dollars, respectively.

Table of Contents

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2011

Contents

Cautionary statement

Key regulatory data	2
Introduction	3
Basel II	3
Pillar 3 disclosures 2011	3
Consolidation basis	5
Scope of Basel II permissions	5
Capital and Risk	
Capital management	6
Capital management and allocation	8
Transferability of capital within the Group	8
Internal assessment of capital adequacy	8
Risk management	11
Overview	11
Risk measurement and reporting systems	12
Credit risk	
Overview and objectives	13
Organisation and responsibilities	13
Risk analytics	13
Credit risk rating systems	14
Application of the IRB approach	20
Application of the standardised approach	29
Counterparty credit risk	31
Securitisation	34
Market risk	
Overview and objectives	39
Organisation and responsibilities	39
Measurement and monitoring	40
Managed risk positions	41
Other risks	
Equity and interest rate risk	42
Non-trading book exposures in equities	42
Non-trading book interest rate risk	43
Operational risk	43
Overview and objectives	43

Organisation and responsibilities 43
Measurement and monitoring 44

Remuneration
HSBC Group remuneration committee 46
HSBC reward strategy 46
Overview of remuneration 47
Group variable pay pool determination 47

Terms and conditions of capital securities 51
Capital securities issued by the Group 51
Tier 1 capital 51
Tier 2 capital 52

Glossary 55

Contacts 62

Tables

1 Basel III phase-in arrangements 4
2 Capital structure 6
3 Risk-weighted assets by risk type and geographical region 7
4 Risk-weighted assets by global business and geographical region 7
5 Credit risk summary 15
6 Credit risk exposure by geographical region 16
7 Risk weightings by geographical region 17
8 Credit risk exposure by industry sector 18
9 Credit risk exposure by residual maturity 19
10 IRB advanced exposure by risk components 22
11 IRB advanced exposure by obligor grade 22
12 IRB foundation exposure 23
13 Retail IRB exposure by geographical region 24
14 IRB exposure credit risk mitigation 27
15 IRB expected loss and impairment charges by exposure class 28
16 IRB expected loss and impairment charges by geographical region 28
17 IRB advanced models projected and actual values 29
18 Standardised exposure by credit quality step 30
19 Standardised exposure credit risk mitigation 31
20 Counterparty credit risk net derivative credit exposure 33
21 Counterparty credit risk exposure by exposure class 33
22 Counterparty credit risk exposure by product 34
23 Counterparty credit risk exposure credit derivative transactions 34
24 Securitisation exposure movement in the year 37
25 Securitisation exposure by trading and non-trading book 37
26 Securitisation exposure asset values and impairment charges 38
27 Securitisation exposure by risk weighting 38
28 Market risk 40
29 Non-trading book equity investments 42
30 Operational risk 44
31 Aggregate remuneration expenditure 45
32 Remuneration fixed and variable amounts 45
33 Deferred remuneration 45
34 Sign-on and severance payments 46
35 Code staff remuneration by band 46
36 2011 Long-term scorecard and performance outcome 50

Table of Contents

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2011 (continued)

Key regulatory data

Capital ratio at 31 December

Components

Risk-weighted assets (RWA s) at 31 December 2011

By composition

Basel II exposure at 31 December 2011

Credit risk by industry sector

RWAs at 31 December 2011

By global business

Expected loss and impairment charges

Comparison

RWAs at 31 December 2011

By geographical region

2

Capital and Risk Management Pillar 3 Disclosures at 31 December 2011 (continued)

Introduction

HSBC is one of the world s largest banking and financial services organisations. We serve around 89 million customers through our four global businesses: Retail Banking and Wealth Management, Commercial Banking, Global Banking and Markets, and Global Private Banking.

Our network of around 7,200 offices covers 85 countries and territories in six geographical regions: Europe, Hong Kong, Rest of Asia-Pacific, Middle East and North Africa (MENA), North America and Latin America.

Listed on the London, Hong Kong, New York, Paris and Bermuda stock exchanges, shares in HSBC Holdings plc are held by over 220,000 shareholders in 132 countries and territories.

Details of the Group s principal activities, business and operating models and strategic direction may be found on page 10 of the Annual Report and Accounts 2011.

Basel II

The United Kingdom (UK) Financial Services Authority (FSA) supervises HSBC on a consolidated basis, and therefore receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. Individual banking subsidiaries are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements.

We calculate capital at a Group level using the Basel II framework of the Basel Committee on Banking Supervision (Basel Committee) as implemented by the FSA. However, local regulators are at different stages of implementation and local reporting may still be on a Basel I basis, notably in the United States (US). In most jurisdictions, non-banking financial subsidiaries are also subject to the supervision and capital requirements of local regulatory authorities.

Basel II is structured around three pillars : minimum capital requirements, supervisory review process and market discipline. The Capital Requirements Directive (CRD) implemented Basel II in the European Union (EU) and the FSA then gave effect to the CRD by including the requirements of the CRD in its own rulebooks.

Pillar 3 disclosures 2011

Pillar 3, market discipline, complements the minimum capital requirements and the supervisory review process. Its aim is to develop disclosures by banks which allow market participants to assess the

scope of application of Basel II, capital, particular risk exposures and risk assessment processes, and hence the capital adequacy of the institution. Under the Pillar 3 framework all material risks must be disclosed, enabling a comprehensive view of the institution s risk profile.

All material and non-proprietary information required by Pillar 3 is included in the *Pillar 3 Disclosures 2011*, which comprise both quantitative and qualitative information and are provided at the HSBC Group consolidated level. The FSA permits certain Pillar 3 requirements to be satisfied by inclusion within the financial statements.

Where we adopt this approach, references are provided to the relevant pages of the Annual Report and Accounts 2011.

Principal changes to disclosures

The principal changes to our *Pillar 3 Disclosures 2011*, compared with the previous year, are those commonly known as Basel 2.5, implemented in the EU via CRD III, which increased the capital and disclosure requirements for re-securitisation exposures and market risk with effect from 31 December 2011. Further details are set out from page 34. In addition, we have replaced a table of counterparty sector exposures with a more granular industry sector analysis (page 18), and further developed our disclosures on remuneration (page 45).

Movement in risk-weighted assets in 2011

RWAs increased by US$106.4bn or 10% in 2011. Exchange rate differences caused a net reduction in RWAs of around US$9bn in the year, and the remaining increase in RWAs of US$115bn arose mainly in credit risk and market risk.

RWAs increased by approximately US$50bn as a result of the introduction of Basel 2.5, net of mitigating actions undertaken by management. Of this increase, around US$40bn was in market risk, of which the largest component was stressed VAR. Higher risk weights on re-securitisations increased credit risk RWAs by around US$10bn, primarily impacting the GB&M legacy portfolios.

The remaining increase in credit risk RWAs largely reflected growth in our global businesses, notably in Commercial Banking, and also included an increase in loan balances in our mainland China associates. Further details of the movement in our RWAs in 2011 may be found on page 211 of the *Annual Report and Accounts 2011*.

Table of Contents

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2011 (continued)

Future developments

The regulation of financial institutions continues to undergo significant change. In the areas of risk and capital management, considerable progress has been made in implementing the G20 governments agenda to increase the stability and resilience of the financial system, and further major changes in regulation are foreseen.

Following Basel Committee issuance in December 2010 of Basel III rules, the European Commission issued in July 2011 its related implementing proposals, known as CRD IV,

comprising a Directive and Regulation which together will supersede earlier Directives. These proposals are currently under review within the European legislative process, which is expected to conclude in 2012.

Significant regulatory matters within the scope of CRD IV include quality and quantity of capital, counterparty credit risk, liquidity and funding, capital buffers and leverage. The new requirements will be phased in from 1 January 2013, as shown in the table below, with many areas subject to development of technical standards by the European Banking Authority and full implementation required by 1 January 2019.

Table 1: Basel III phase-in arrangements

	2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	%	%	%	%	%	%	%
Minimum common equity capital ratio	3.5	4.0	4.5	4.5	4.5	4.5	4.5
Capital conservation buffer				0.625	1.25	1.875	2.5
Minimum common equity plus capital conservation buffer	3.5	4.0	4.5	5.125	5.75	6.375	7.0
Minimum tier 1 ratio	4.5	5.5	6.0	6.0	6.0	6.0	6.0
Minimum total capital plus conservation buffer	8.0	8.0	8.0	8.625	9.25	9.875	10.5

In September 2011, the UK Independent Commission on Banking published its final Report, to which the Government responded before year end. At a global level, in November, the Basel Committee issued its final rules for the enhanced supervision of institutions designated global systemically important banks (G-SIBs). The capital requirements of HSBC, as a G-SIB, could be significantly affected by these measures, which are in addition to those expected under CRD IV.

An overview of the above, together with related developments on the G20 agenda for financial sector regulation, may be found in the discussion of macro-prudential and regulatory risks on page 100 of the *Annual Report and Accounts 2011*. An assessment of the impact of Basel III, measures for G-SIBs and various mitigating actions by management on our capital position and our target core tier 1 ratio may be found in the Capital section on page 212 of the *Annual Report and Accounts 2011*.

Frequency

We publish comprehensive Pillar 3 disclosures annually on the HSBC internet site, with summarised regulatory capital information provided in our interim reports and management statements.

Comparison with the *Annual Report and Accounts 2011*

The *Pillar 3 Disclosures 2011* have been prepared in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with International Financial Reporting Standards (IFRS   s). Therefore, some information in the *Pillar 3 Disclosures 2011* is not directly comparable with the financial information in the *Annual Report and Accounts 2011*. This is most pronounced for the credit risk disclosures, where credit exposure is defined as the amount at risk that is estimated by the Group under specified Basel II parameters. This differs from similar information in the *Annual Report and Accounts 2011*, which is mainly reported at the balance sheet date and therefore does not reflect the likelihood of future drawings of committed credit lines.

Verification

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

Significant subsidiaries

Links to the financial information of significant subsidiaries, including capital resources and requirements, are available on our investor relations website page www.hsbc.com/investor-relations/financial-results/hsbc-group-companies.

4

Capital and Risk Management Pillar 3 Disclosures at 31 December 2011 (continued)

Consolidation basis

The basis of consolidation for financial accounting purposes is described on page 292 of the *Annual Report and Accounts 2011* and differs from that used for regulatory purposes. Investments in banking associates are equity accounted in the financial accounting consolidation, whereas their exposures are proportionally consolidated for regulatory purposes. Subsidiaries and associates engaged in insurance and non-financial activities are excluded from the regulatory consolidation and are deducted from regulatory capital. The regulatory consolidation does not include special purpose entities (SPE s) where significant risk has been transferred to third parties. Exposures to these SPEs are risk-weighted as securitisation positions for regulatory purposes.

Scope of Basel II permissions

Credit risk capital requirements

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

The capital resources requirement, which is intended to cover unexpected losses, is derived from a formula specified in the regulatory rules, which incorporates PD, LGD, EAD and other variables such as maturity and correlation. Expected losses under the IRB approaches are calculated by multiplying PD by EAD and LGD. Expected losses are deducted from capital to the extent that they exceed total accounting impairment allowances.

For consolidated Group reporting, we have adopted the IRB advanced approach for the majority of our business. A number of Group companies and portfolios are in transition to IRB advanced from standardised or IRB foundation approaches, pending definition of local regulations or model development and approval; others will remain on standardised

under exemptions from IRB treatment. Approaches used for securitisation exposures are described on page 36.

Counterparty credit risk capital requirement

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

We use the mark-to-market and IMM approaches for counterparty credit risk. Our longer-term aim is to migrate more positions from the mark-to-market to the IMM approach.

Market risk capital requirement

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

The market risk capital requirement is measured using internal market risk models, where approved by the FSA, or the FSA standard rules. Following the implementation of Basel 2.5, our internal market risk models comprise VAR, stressed VAR, incremental risk charge and correlation trading under the comprehensive risk measure.

The majority of our market risk is subject to internal models, and we continue to increase the proportion that is assessed this way.

Operational risk capital requirement

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

We have adopted the standardised approach in determining our operational risk capital requirement.

Table of Contents

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2011 (continued)

Capital and Risk

Capital management

Table 2: Capital structure

	At 31 December	
	2011	2010
	US$bn	US$bn
Composition of regulatory capital		
Tier 1 capital		
Shareholders equity	**154.1**	142.7
Shareholders equity per balance sheet[1]	**158.7**	147.7
Preference share premium	**(1.4)**	(1.4)
Other equity instruments	**(5.9)**	(5.9)
Deconsolidation of special purpose entities[2]	**2.7**	2.3
Non-controlling interests	**4.0**	3.9
Non-controlling interests per balance sheet	**7.4**	7.2