HSBC HOLDINGS PLC
Form 6-K
February 28, 2014
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 February 2014

Commission File Number: 001-14930

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 if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): ¨

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Yes ¨ No x

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HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

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 w 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.

Cautionary statement regarding forward-looking statements

The Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (Pillar 3 Disclosures 2013) contain *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 similar expressions are intended 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.

Verification

Whilst the Pillar 3 Disclosures 2013 *are not required to be externally audited, the document has been verified internally in accordance with the Group s policies on disclosure and its financial reporting and governance processes. Controls comparable to those for the* Annual Report and Accounts 2013 *have been applied to confirm compliance with PRA Handbook rules in BIPRU 11 and consistency with HSBC s governance, business model and other disclosures.*

Frequency

We publish comprehensive Pillar 3 disclosures annually on the HSBC internet site www.hsbc.com, simultaneously with the release of our Annual Report and Accounts 2013. *Our interim reports and management statements include relevant summarised regulatory capital information complementing the financial and risk information presented there.*

Contents

Introduction

Purpose	2
Key regulatory metrics	2
Regulatory framework for disclosures	4

Pillar 3 Disclosures 2013	5
Future developments	5
Comparison with the *Annual Report and Accounts 2013*	9
Capital and risk	
Capital management	14
Regulatory capital	14
Calculation of capital requirements	16
Scope of Basel Pillar 1 approaches	19
Pillar 2 and ICAAP	22
Basel III implementation and CRD IV	23
Risk management	29
Risk analytics and model governance	30
Credit risk	
Overview and responsibilities	31
Credit risk management	31
Credit risk models governance	32
Application of the IRB approach	41
Model performance	59
Risk mitigation	65
Application of the standardised approach	67
Counterparty credit risk	69
Securitisation	76
Market risk	
Overview and objectives	81
Organisation and responsibilities	81
Measurement and monitoring	82
Managed risk positions	84
Operational risk	
Overview and objectives	84
Organisation and responsibilities	85
Measurement and monitoring	86
Other risks	
Pension risk	86
Non-trading book interest rate risk	87
Non-trading book exposures in equities	87
Remuneration	
HSBC Group Remuneration Committee	91
HSBC reward strategy	91
Group variable pay pool determination	91
Appendices	
I Simplified organisation chart for regulatory purposes	97
II Risk management framework risk types	98
III Supplementary Basel III disclosures	101
IV References to *Annual Report and Accounts 2013*	104
V Abbreviations	105
VI Glossary	107
VII Contacts	115

Table of Contents

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Tables

1	Pillar 1 overview	3
2	Reconciliation of balance sheets - financial accounting to regulatory scope of consolidation	10
3	Principal entities with a different regulatory and accounting scope of consolidation	12
4	Composition of regulatory capital	15
5	RWAs - by global business and region	16
6	RWAs - by risk type and region	17
7	Credit risk and counterparty credit risk - by Basel approach and exposure class	21
8	Composition of regulatory capital on an estimated CRD IV end point basis and Year 1 transitional basis	24
9	Reconciliation of current rules to CRD IV end point rules	25
10	Estimated CRD IV end point leverage ratio	28
11	Credit risk - summary	33
12	Credit risk exposure - by region	34
13	Credit risk exposure - RWAs by region	35
14	Credit risk exposure - RWA density by region	36
15	Credit risk exposure - by industry sector	38
16	Credit risk exposure - by residual maturity	40
17	Wholesale IRB credit risk models	43
18	Corporate IRB portfolio analysis	44
19	Wholesale IRB exposure - by obligor grade	45
20	Material Retail IRB risk rating systems	51
21	Retail IRB exposures secured on real estate property	53
22	Retail IRB exposure - by internal PD band	54
23	Retail IRB exposure - by region	57
24	IRB models - estimated and actual values (wholesale)	60
25	IRB models - corporate PD models - performance by CRR grade	60
26	IRB models - estimated and actual values (retail)	62
27	IRB EL and impairment - by exposure class	63
28	IRB EL and impairment - by region	64
29	IRB exposure - credit risk mitigation	67
30	Standardised exposure - credit risk mitigation	68
31	Standardised exposure - by credit quality step	69
32	CCR exposure - credit derivative transactions	70
33	CCR - net derivative credit exposure	71
34	Comparison of derivative accounting balances and CCR exposure	71
35	CCR - by exposure class, product and method	72
36	CCR - by exposure class, product and region	73
37	CCR - RWAs by exposure class, product and region	74
38	CCR - RWA density by exposure class, product and region	75
39	Securitisation - by approach	78
40	Securitisation - movement in the year	78
41	Securitisation - by trading and non-trading book	79
42	Securitisation - asset values and impairment charges	79
43	Securitisation - by risk weighting	80
44	Market risk	81
45	Market risk models	84
46	Operational risk	85
47	Non-trading book equity investments	88
48	Aggregate remuneration expenditure	89

49	Remuneration - fixed and variable amounts - Group	89
50	Remuneration - fixed and variable amounts - UK	89
51	Deferred remuneration	90
52	Sign-on and severance payments	90
53	Code staff remuneration by band	90
54	2013 GPSP scorecard and performance outcome	95

Who we are

HSBC is one of the largest banking and financial services organisations in the world.

Customers:

54 million

Served by:

254,000 employees

Through four global businesses:

Retail Banking and Wealth Management

Commercial Banking

Global Banking and Markets

Global Private Banking

Located in:

75 countries and territories

Across six geographical regions:

Europe

Hong Kong

Rest of Asia-Pacific

Middle East and North Africa

North America

Latin America

Offices:

Over 6,300

Global headquarters:

London

Market capitalisation:

US$207 billion

Listed on stock exchanges in:

London

Hong Kong

New York

Paris

Bermuda

Shareholders:

216,000 in 131 countries and territories

1

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Introduction

Purpose

This document comprises HSBC s Pillar 3 disclosures on capital and risk management at 31 December 2013. It has two principal purposes:

- to meet the regulatory disclosure requirements under the rules of the United Kingdom (UK) Prudential Regulation Authority (PRA) set out in BIPRU, the Prudential Sourcebook for Banks, Building Societies and Investment Firms, Chapter 11, and as the PRA has otherwise directed; and

- to provide further useful information on the capital and risk profile of the HSBC Group, in particular on the impact of the European and UK implementation of the Basel III framework.

Additional relevant information may be found in the HSBC Holdings plc *Annual Report and Accounts 2013*.

Key regulatory metrics

Core tier 1 capital	**Core tier 1 ratio**	**Total RWAs**
US$149.1bn *up 7%*	13.6%	US$1,093bn *down 3%*
2012: US$138.8bn 2011: US$122.4bn	2012: 12.3% 2011: 10.1%	2012: US$1,124bn 2011: US$1,210bn
Tier 1 capital	**Tier 1 ratio**	**Credit risk EAD**
US$158.2bn *up 5%*	14.5%	US$2,160bn *down 1%*
2012: US$151.0bn 2011: US$139.5bn	2012: 13.4% 2011: 11.5%	2012: US$2,171bn 2011: US$2,183bn
Total regulatory capital	**Total capital ratio**	**Credit risk RWA density**
US$194.0bn *up7%*	17.8%	40%
2012: US$180.8bn 2011: US$170.3bn	2012: 16.1% 2011: 14.1%	2012: 41% 2011: 44%
Common equity tier 1 capital	**Common equity tier 1 ratio[1]**	**Estimated CRD IV RWAs**
US$132.5bn *up 8%*	10.9%	US$1,215bn *down 6%*
2012: US$122.5bn	2012: 9.5%	2012: US$1,292bn

Leverage ratio[2]

4.4%

2012: 4.2%

2

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Table 1: Pillar 1 overview

	RWAs			Capital required[3]	
	2013	2012		**2013**	2012
	US$bn	US$bn		**US$bn**	US$bn
Credit risk	**864.3**	898.4	*down 4%*	**69.1**	71.9
Standardised approach	**329.5**	374.5		**26.4**	30.0
IRB foundation approach	**13.6**	10.3		**1.1**	0.8
IRB advanced approach	**521.2**	513.6		**41.6**	41.1
Counterparty credit risk[4]	**45.8**	48.3	*down 5%*	**3.7**	3.9
Standardised approach	**3.6**	2.6		**0.3**	0.2
IRB approach	**42.2**	45.7		**3.4**	3.7
Market risk	**63.4**	54.9	*up 15%*	**5.1**	4.4
Operational risk	**119.2**	122.3	*down 3%*	**9.5**	9.8
Total	**1,092.7**	1,123.9	*down 3%*	**87.4**	90.0
Of which:					
Run-off portfolios	**104.9**	145.7		**8.4**	11.7
Legacy credit in GB&M	**26.4**	38.6		**2.1**	3.1
US CML and Other[5]	**78.5**	107.1		**6.3**	8.6
Card and Retail Services[6]	**1.1**	6.9		**0.1**	0.6

1 *A Basel III measure of common equity tier 1 (CET 1) capital expressed as a percentage of total risk exposure amount.*
2 *For a detailed basis of preparation, see Appendix III.*
3 *Capital required , here and in all tables where the term is used, represents the Pillar I capital charge at 8% of RWAs.*
4 *For a breakdown of counterparty credit risk (CCR) exposure and RWAs by internal model and mark-to-market methods, see table 35.*
5 *Other includes treasury services related to the US Consumer and Mortgage Lending (CML) business and operations in run-off.*
6 *Operational risk RWAs, under the standardised approach, are calculated using an average of the last three years revenues. For business disposals, the operational risk RWAs are not released immediately on disposal, but diminish over a period of time. The RWAs for the Card and Retail Services business at 31 December 2013 represent the remaining operational risk RWAs for this business.*

RWAs by risk type

Credit risk RWAs by Basel approach

RWAs by geographical region

RWAs by global business

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Regulatory framework for disclosures

HSBC is supervised on a consolidated basis in the UK where, on 1 April 2013, three new regulatory bodies were established: the Financial Policy Committee (FPC), the PRA and the Financial Conduct Authority (FCA).

The FPC does not directly supervise firms, being responsible for macro-prudential regulation and considering systemic risk affecting economic and financial stability. The FPC does, however, have power to direct the PRA or FCA, and it may make recommendations to the Treasury, to the PRA, FCA or other persons . The PRA and FCA inherited the micro-prudential supervisory functions of the Financial Services Authority (FSA), and hold formal powers to issue directions to qualifying parent undertaking entities such as HSBC Holdings plc.

As the PRA supervises HSBC on a consolidated basis, it 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 local capital adequacy requirements. In most jurisdictions, non-banking financial subsidiaries are also subject to the supervision and capital requirements of local regulatory authorities.

At consolidated group level, we calculated capital for prudential regulatory reporting purposes throughout 2013 using the Basel II framework of the Basel Committee on Banking Supervision (Basel Committee), as implemented by the European Union (EU) in the (amended) Capital Requirements Directive, and subsequently by the FSA and, latterly, the PRA in their rulebooks for the UK banking industry.

The Basel II framework has been updated by the Basel Committee in Basel III, which in the EU has been implemented with legal effect from 1 January 2014 through a Directive and a Regulation (CRD IV) which together supersede earlier Directives. Significant matters within the scope of CRD IV include the quality and quantity of regulatory capital, the calculation of capital requirements for major risk types, liquidity and funding, capital buffers and leverage.

The regulators of Group banking entities outside the EU are at varying stages of implementation of the Basel framework; local regulation in 2013 may have been still on a Basel I basis, on Basel II, or in some cases already on Basel III.

In December 2013, the PRA issued final rules implementing CRD IV in the UK. In summary, these deploy available national discretion in order to accelerate significantly the transition timetable to full end-point CRD IV compliance. They apply to HSBC, being headquartered in the UK, on a group consolidated basis. Details are set out under Basel III implementation and CRD IV on page 23 of this Report.

Important elements of the capital adequacy framework in the UK have yet to be clarified, and uncertainties remain around the amount of capital that banks will be required to hold. These include the quantification and interaction of capital buffers and the definitions of several significant adjustments to regulatory capital. In addition, many technical standards and guidelines have been issued by the European Banking Authority (EBA) in draft form for consultation, or are pending publication in 2014. These require adoption by the European Commission to come legally into force.

Moreover, the environment for approval and operation of internal ratings-based (IRB) analytical models remains challenging. During 2013, the PRA introduced a number of measures to constrain modelling approaches used to calculate RWAs; these generally have driven higher capital requirements. These measures included a 45% floor for loss-given-default (LGD) on senior unsecured sovereign IRB exposures and a requirement to adopt supervisory slotting for certain commercial real estate exposures. Given that all European Economic Area (EEA) sovereign exposures are treated under the standardised approach, the new LGD floor effectively only applies to non-EEA sovereign exposures. Further details are set out in the RWA commentary from page 17 and in Wholesale models from page 42 below.

In November 2013, the PRA published its expectations in relation to capital ratios of major UK banks and building societies, namely that from 1 January 2014 capital resources should be held equivalent to at least 7% of RWAs, using a CRD IV end point definition of CET1 but after taking into account any adjustments set by the PRA to reflect the FPC s capital shortfall exercise recommendations. These include an assessment

of expected future losses and future costs of conduct redress, and adjusting for a more prudent calculation of risk weights. In addition to the above, the PRA has established for the Group a forward-looking Basel III end point CET1 target ratio, post-FPC adjustments, to be met by 2019. This effectively replaced the capital resources floor that was set by the FSA towards the end of 2012.

4

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Our approach to managing Group capital is designed to ensure that we exceed current regulatory requirements and are well placed to meet those expected in the future. In 2013, we managed our capital position to meet an internal target CET1 ratio of 9.5-10.5% on a CRD IV end point basis, changing to greater than 10% from 1 January 2014. We continue to keep this under review.

Pillar 3 Disclosures 2013

Basel II is structured around three pillars . The Pillar 1 minimum capital requirements and Pillar 2 supervisory review process are complemented by Pillar 3: market discipline. The aim of Pillar 3 is to produce disclosures which allow market participants to assess the scope of application by banks of the Basel framework and the rules in their jurisdiction, their capital condition, risk exposures and risk assessment processes, and hence their capital adequacy. Pillar 3 requires all material risks to be disclosed, enabling a comprehensive view of a bank s risk profile.

The *Pillar 3 Disclosures 2013* comprise all information required under Pillar 3 in the UK, both quantitative and qualitative, and are prepared at the HSBC Group consolidated level. Where disclosure has been withheld as proprietary or non-material, as the rules permit, we comment as appropriate. The PRA also allows certain Pillar 3 requirements to be met by inclusion within the financial statements.

Where we adopt this approach, references are provided to the relevant pages of the Annual Report and Accounts 2013.

We continue to engage constructively in the work of the UK authorities and industry associations to improve the transparency and comparability of UK banks Pillar 3 disclosures. We also take due account of other regulatory assessments, such as reviews by the EBA of best practice in historical disclosures. Our 2013 disclosures further enhance our implementation at 2012 year-end of the recommendations of the Enhanced Disclosure Task Force (EDTF) in October 2012, taking account of their subsequent progress report.

An overview of disclosures reflecting HSBC s implementation of those recommendations is given on page 131 of the Annual Report and Accounts 2013.

The disclosures in this report have mainly been prepared according to the Basel II rules that remained in place until and at 2013 year-end.

With CRD IV coming into force on 1 January 2014, and reflecting the way we now manage capital, we have further developed our disclosures of our estimated capital position at 2013 year-end on an end point CRD IV basis with regard to both the supply of, and the demand for, capital. We also make certain disclosures in line with PRA requirements for UK banks on the composition of capital and leverage in a Basel III/ CRD IV environment. These disclosures are clearly distinguished from those made on a Basel II basis.

The principal changes to our *Pillar 3 Disclosures 2013,* compared with the prior year, are:

enhanced capital and leverage disclosures:

an extended analysis of the different scope of our financial accounting and regulatory balance sheets;

development of tables on the composition of regulatory capital on transitional and end-point CRD IV bases; and

a reconciliation of the leverage ratio exposure measure to financial balance sheet assets.

more granular risk disclosures:

new tables on the key characteristics of our principal credit IRB models, wholesale and retail, and market risk models;

a corporate portfolio analysis by geography;

more granular backtesting data for retail risk analytical models; and

an improved analysis of expected loss (EL), impairment charges and allowances.

other items:

enhancement of the Glossary; and

presentational improvements, e.g. charts for Tables 19 and 22 on portfolio quality distribution.

Future developments

UK regulatory update

The UK authorities have a number of areas of ongoing regulatory focus. A common theme is the ability of banks internal models to adequately capture the risk of the portfolio.

During 2013, the PRA proposed a wholesale LGD and exposure at default (EAD) framework to UK banks that includes the treatment of low-default portfolios. This imposed LGD and EAD floors based on the foundation approach in the case of portfolios with data quality shortcomings and also those with fewer than 20 events of default per country.

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

In December 2013, the PRA concluded its review of HSBC and confirmed that the floors should be implemented across a range of portfolios by the end of March 2014. Work is underway to implement the change, which is currently estimated to have a negative impact on our CET1 ratio in the range of 25bps to 35bps.

In December 2013, the PRA issued its Supervisory Statement SS13/13 in relation to Market Risk. This requires firms to identify risks not adequately captured by models and to hold additional funds against those under its Risks not in VaR (RNIV) framework. In assessing these risks, no offsetting or diversification will be allowed across risk factors. To align with this, we are currently reviewing and revising our methodology.

In July 2013, the EBA published a consultation paper on prudent valuation together with a Quantitative Impact Study. We await the outcome of the EBA consultation process and the finalised standard during 2014.

Systemically important banks

In parallel with the Basel III proposals, the Basel Committee issued a consultative document in July 2011, Global systemically important banks: assessment methodology and the additional loss absorbency requirement . In November 2011, it published its rules and the Financial Stability Board (FSB) issued the initial list of global systemically important banks (G-SIB s). This list, which includes HSBC and 28 other major banks from around the world, will be re-assessed periodically through annual re-scoring of the individual banks and a triennial review of the methodology.

The banks included in the list, depending on their relative ranking, will be required to hold a buffer in the form of CET1 capital on a scale between 1% and 2.5%. The requirements, initially for those banks identified as G-SIBs in November 2014, on the basis of end-2013 data, are envisaged to be phased in from 1 January 2016, becoming fully effective on 1 January 2019. However, national regulators have discretion to introduce higher thresholds than the minima.

In July 2013, the Basel Committee issued updated final rules, Global systemically important banks: updated assessment methodology and the additional loss absorbency requirement . Based on this, in November 2013 the FSB and the Basel Committee updated the list of G-SIBs, using end-2012 data. One more institution was added to the list of 28 banking groups identified as G-SIBs in 2012, increasing the overall number to 29. The add-

on of 2.5% previously assigned to HSBC was left unchanged.

The EBA is currently consulting on the implementation of the Basel methodology within the EU.

Regulatory capital buffers

CRD IV, in addition to giving effect to the Basel Committee s surcharge for G-SIBs in the form of a global systemically important institutions buffer (G-SIIB), establishes a number of additional capital buffers, to be met by CET1 capital, broadly aligned with the Basel III framework. CRD IV contemplates that these will be phased in from 1 January 2016, subject to national discretion.

These new capital requirements include a capital conservation buffer designed to ensure banks build up capital outside periods of stress that can be drawn down when losses are incurred, set at 2.5% of RWAs.

Additionally, CRD IV sets out a systemic risk buffer (SRB) for the financial sector as a whole, or one or more sub-sectors, to be deployed as necessary by each EU member state with a view to mitigate structural macro-prudential risk. It is expected that, if such a risk was found to be prevalent, the SRB would be set at a minimum of 1% of the exposures to which it would apply. This is not restricted to exposures within the

member state itself. To the extent it would apply at a global level, it is expected that the higher of the G-SIIB and the SRB would apply.

To implement the CRD IV capital buffers in the UK, in August 2013 the PRA issued a consultation proposing changes to the Pillar 2 framework and explaining its interaction with the buffers. Under the Pillar 2 framework, banks are already required to hold capital in respect of the internal capital adequacy assessment and supervisory review which leads to a final determination by the PRA of individual capital guidance under Pillar 2A. This is currently met by total capital, and in accordance with PS 7/13, is now to be met 56% by CET1 from 1 January 2015.

The PRA also proposed to introduce a PRA buffer, to replace the current capital planning add-on (known as Pillar 2B), also to be held in the form of CET1 capital.

The PRA buffer is intended to be calculated independently and then compared to the extent to which other CRD IV buffers may already cover the same risks. Depending upon the business undertaken by an individual firm, the PRA has

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

stated its expectation that the capital conservation buffer and relevant systemic buffers should serve a similar purpose to the PRA buffer and therefore be deducted from it.

In PS 7/13, the PRA delayed the publication of the remaining rules on capital buffers, pending confirmation from HM Treasury of the UK authority responsible for setting the systemic buffers. The designated UK authority will have the discretion to set the precise buffer rates above the CRD IV minima and to accelerate the timetable for their implementation.

CRD IV also contemplates a cyclical buffer in line with Basel III, in the form of an institution- specific countercyclical capital buffer (CCB), to protect against future losses where unsustainable levels of leverage, debt or credit growth pose a systemic threat. Should a CCB be required, it is expected to be set in the range of 0-2.5%, whereby the rate shall consist of the weighted average of the CCB rates that apply in the jurisdictions where relevant exposures are located.

In January 2014, the FPC issued a policy statement on its powers to supplement capital requirements, through use of the CCB and the sectoral capital requirements (SCR) tools. The CCB allows the FPC to raise capital requirements above the microprudential level for all exposures to borrowers in the UK. The SCR is a more targeted tool which allows the FPC to increase capital requirements above minimum regulatory standards for exposures to three broad sectors judged to pose a risk to the stability of the financial system as a whole: residential and commercial property; and other parts of the financial sector, potentially on a global basis.

In October 2013, the Bank of England published a discussion paper A framework for stress testing the UK banking system . The framework replaces the current stress testing for the capital planning buffer with annual concurrent stress tests, the results of which are expected to inform the setting of the PRA buffer, the CCB, sectoral capital requirements and other FPC recommendations to the PRA. The PRA is expected to further consult on Pillar 2, the transition to the PRA buffer and the relationship between the PRA buffer and the stress testing exercise in 2014.

Until outstanding consultations are published and guidance issued, there remains uncertainty as to the interaction between these buffers, the exact buffer rate requirements and the ultimate capital impact.

For a high-level representation of the proposed buffers under the new regime, see figure below.

Potential effect of regulatory proposals on HSBC s capital requirements

Given the developments outlined above, it remains uncertain what HSBC s final capital requirement will be. However, elements of the capital requirements that are known to date are as follows:

	%
Minimum CET1[1]	**4.5**
Capital conservation buffer[1]	**2.5**
G-SIIB buffer (to be phased in up to 2019)[2]	**2.5**

1 *In November 2013, the PRA published its expectations that from 1 January 2014, capital resources should be held equivalent to at least 7% of risk-weighted assets using a CRD IV end point definition of CET1 but after taking into account any adjustments set by the PRA to reflect the FPC s capital shortfall exercise*

recommendations. We assume but it has not yet been confirmed that the 7% constitutes the 4.5% minimum CET1 and the 2.5% capital conservation buffer requirements.

2 *The systemic buffers are still pending transposition in the UK.*

7

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

In December 2011, against the backdrop of eurozone instability, the EBA recommended that banks aim to reach a 9% EBA-defined core tier 1 ratio by the end of June 2012. In July 2013, the EBA replaced the 2011 recapitalisation recommendation with a new measure on capital preservation. This equates for HSBC to US$104bn, compared with actual core tier 1 capital held of US$141bn at 30 June 2013. To monitor this, banks submitted additional reporting and capital plans in November 2013 to demonstrate that appropriate levels of capital are being preserved. The EBA indicated they will review this recommendation by December 2014.

RWA integrity

In July 2013, the Basel Committee published its findings on the Analysis of risk-weighted assets for credit risk in the banking book , reporting that while the majority of RWA variability arises from the underlying credit quality of a portfolio, differences also arise from banks choices under the IRB approach. One of its recommendations to counteract this variance was the introduction of new or increased capital floors.

In parallel with the above and as part of the review of the Basel capital framework, also in July 2013, the Basel Committee published a discussion paper on its findings, The regulatory framework: balancing risk sensitivity, simplicity and comparability . The Basel Committee proposed that a range of measures should be considered, including the possibility of additional floors, as a potential tool to constrain the effect of variation in RWAs derived from internal model outputs, to provide further comfort that banks risks are adequately capitalised and to make capital ratios more comparable.

In November 2013, the FPC postponed a decision on whether to propose parallel RWA disclosures by UK banks on the Basel standardised approach, pending further assessment by the PRA of the merits, cost and benefits of such a proposition.

In December 2013, the EBA published the final results of its investigation into RWAs in the banking book, aimed at identifying any material difference in RWA outcomes between banks and understanding the sources of such differences. The report concluded that differences in implementation of the IRB approach were linked to differences in practice on the part of both supervisors and banks.

The EBA set out a number of policy recommendations to address its findings. These

include enhancing the disclosure and transparency of RWA-related information, supporting supervisors in properly implementing the single rulebook with the delivery of existing mandates set out in CRD IV and developing additional guidance that specifically addresses and facilitates consistency in supervisory and bank practice.

We are reviewing these proposals and aim to further develop the measures that have already been taken to support and provide transparency to our metrics, such as RWA flow analysis (on pages 302 and 303 of the *Annual Report and Accounts 2013*) and RWA density analysis (on page 36 of this report), which reflects our compliance with the EDTF framework.

Structural banking reform

The Independent Commission on Banking (ICB) published its final report in September 2011 and the UK government expressed broad approval for the principle of establishing a ring-fenced bank for retail banking activities and greater loss absorbing capacity.

In December 2013, the UK s Financial Services (Banking Reform) Act 2013 received Royal Assent, becoming primary legislation. It implements the recommendations of the ICB and of the Parliamentary Commission on Banking Standards, which *inter alia* establish a framework for ring-fencing the UK retail banking from trading activities, and sets out requirements for loss absorbency in the form of equity capital and loss absorbing debt. The PRA, subject to the approval of HM Treasury, is empowered to require banking groups to restructure their operations if it considers that the operation of the ring-fence in a group is proving to be ineffective. The exercise of these powers may lead to groups being required to split their retail and investment banking operations into separate corporate groups. A consultation has also taken place on draft

secondary legislation setting out further details but the underlying rules from supervisory authorities are not yet available.

The UK s Financial Services (Banking Reform) Act 2013 also creates a bail-in mechanism as an additional resolution tool alongside existing options to transfer all or part of the bank to a private sector purchaser, to transfer parts of the bank to a new bridge bank which is later sold or takes the bank into temporary public sector ownership. In a bail-in , shareholders and creditors in the bank have their investments written down in value or converted into new interests (such as new shares) without the bank being placed in

liquidation. This allows the bank to continue to provide its core banking services without interruption and ensures that the solvency of the bank is addressed without taxpayer support, while also allowing the Bank of England to provide temporary funding to this newly solvent bank. Certain liabilities such as deposits protected by the Financial Services Compensation Scheme are excluded from bail-in. It is intended that these bail-in provisions will be consistent with the European Recovery and Resolution Directive once it comes into force.

The UK government intends to complete the legislative process by the end of this Parliament in May 2015 and to have reforms in place by 2019.

In February 2012, the European Commission appointed a High Level Expert Group under the Governor of the Bank of Finland, Erkki Liikanen, to consider potential structural changes in banks within the EU. The group recommended, *inter alia*, the ring-fencing of certain market-making and trading activities from the deposit-taking and retail payments activities of major banks and possible amendments to the use of bail-in instruments as a resolution tool, as well as a number of other comments.

In January 2014, following a consultation period, the European Commission published its own legislative proposals on the structural reform of the European banking sector which would prohibit proprietary trading in financial instruments and commodities, and enable supervisors to require trading activities such as market-making, complex derivatives and securitisation operations to be undertaken in a separate subsidiary from deposit taking activities.

The ring-fenced deposit taking entity would be subject to separation from the trading entity including capital and management structures, issuance of own debt and arms-length transactions between entities.

The proposals allow for derogation from these requirements for super-equivalent national regimes.

On the current basis, it is understood that non-EU subsidiaries of the Group which could be separately resolved without a threat to the financial stability of the EU would be excluded from the proposals.

The proposals will now be subject to discussion in the European Parliament and the Council of Ministers (representing the EU member states) and are not expected to be finalised in 2014. The implementation date for any separation under the final rules would depend upon the date on which the final legislation is agreed.

The relationship between the UK, French, German and any EU proposals has still to be clarified (as does the interactivity between any of these proposals and the US Volcker Rule), although the G20 has asked the FSB, in collaboration with the IMF and OECD, to assess the cross-border consistency and global financial stability implications of structural measures, to be completed by the end of 2014.

Comparison with the *Annual Report and Accounts 2013*

Basis of consolidation

The basis of consolidation for the purpose of financial accounting under International Financial Reporting Standards (IFRSs), described on page 430 of the *Annual Report and Accounts 2013,* differs from that used for regulatory purposes as described in Structure of the regulatory group on page 12. Table 2 below provides a reconciliation of the balance sheet from the financial accounting to the regulatory scope of consolidation.

It is the regulatory balance sheet, and not the financial accounting balance sheet, which forms the basis for the calculation of regulatory capital requirements. The alphabetic references in this table link to the corresponding references in table 4: Composition of Regulatory Capital on page 15, identifying those balances which form part of that calculation.

Table of Contents

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Table 2: Reconciliation of balance sheets financial accounting to regulatory scope of consolidation

	Ref	At 31 December 2013			
		Accounting balance sheet US$m	Deconsolidation of insurance/ other entities US$m	Consolidation of banking associates US$m	Regulatory balance sheet US$m
Assets					
Trading assets		303,192	32	1,686	304,910
Loans and advances to customers		1,080,304	(13,182)	110,168	1,177,290
of which:					
impairment allowances on IRB portfolios	*i*	(9,476)			(9,476)
impairment allowances on standardised portfolios	*k*	(5,667)		(2,465)	(8,132)
Financial investments		425,925	(52,680)	31,430	404,675
Capital invested in insurance and other entities			9,135		9,135
Interests in associates and joint ventures		16,640		(15,982)	658
of which:					
positive goodwill on acquisition	*h*	608		(593)	15
Goodwill and intangible assets	*h*	29,918	(5,369)	631	25,180
Other assets		815,339	(37,634)	57,477	835,182
of which:					
goodwill and intangible assets of disposal groups held for sale	*h*	3			3
retirement benefit assets	*g*	2,140			2,140
impairment allowances on assets held for sale		(111)			(111)
of which:					
IRB portfolios	*i*				
standardised portfolios	*k*	(111)			(111)
Total assets		2,671,318	(99,698)	185,410	2,757,030
Liabilities and equity					
Deposits by banks		129,212	(193)	33,296	162,315
Customer accounts		1,482,812	(711)	142,924	1,625,025
Trading liabilities		207,025	(129)	161	207,057
Financial liabilities designated at fair value		89,084	(13,471)		75,613
of which:					
term subordinated debt included in tier 2 capital	*m*	18,230			18,230
hybrid capital securities included in tier 1 capital	*j*	3,685			3,685
Debt securities in issue		104,080	(9,692)	1,021	95,409
Retirement benefit liabilities	*g*	2,931	(11)	56	2,976
Subordinated liabilities		28,976	2	2,961	31,939
of which:					
hybrid capital securities included in tier 1 capital.	*j*	2,873			2,873

perpetual subordinated debt included in tier 2 capital	*l*	**2,777**			**2,777**
term subordinated debt included in tier 2 capital	*m*	**23,326**			**23,326**
Other liabilities		**436,739**	**(73,570)**	**4,991**	**368,160**
of which:					
contingent liabilities and contractual commitments		**177**			**177**
of which:					
credit-related provisions on IRB portfolios	*i*	**155**			**155**
credit-related provisions on standardised portfolios	*k*	**22**			**22**
Total shareholders equity	*a*	**181,871**	**(1,166)**		**180,705**
of which:					
other equity instruments included in tier 1 capital	*c, j*	**5,851**			**5,851**
preference share premium included in tier 1 capital	*b*	**1,405**			**1,405**
Non-controlling interests	*d*	**8,588**	**(757)**		**7,831**
of which:					
non-cumulative preference shares issued by subsidiaries included in tier 1 capital	*e*	**2,388**			**2,388**
non-controlling interests included in tier 2 capital, cumulative preferred stock	*f*	**300**			**300**
non-controlling interests attributable to holders of ordinary shares in subsidiaries included in tier 2 capital	*f,m*	**188**			**188**
Total liabilities and equity		**2,671,318**	**(99,698)**	**185,410**	**2,757,030**

10

Table of Contents

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Reconciliation of balance sheets financial accounting to regulatory scope of consolidations

		At 31 December 2012			
	Ref	Accounting balance sheet US$m	Decon-solidation of insurance/ other entities US$m	Consolidation of banking associates US$m	Regulatory balance sheet US$m
Assets					
Trading assets		408,811	(144)	1,477	410,144
Loans and advances to customers		997,623	(11,957)	119,698	1,105,364
of which:					
impairment allowances on IRB portfolios	*i*	(10,255)			(10,255)
impairment allowances on standardised portfolios	*k*	(5,857)		(2,726)	(8,583)
Financial investments		421,101	(50,256)	33,110	403,955
Capital invested in insurance and other entities			8,384		8,384
Interests in associates and joint ventures		17,834		(17,127)	707
of which:					
positive goodwill on acquisition	*h*	670		(640)	30
Goodwill and intangible assets	*h*	29,853	(4,983)	687	25,557
Other assets		817,316	(34,672)	82,469	865,113
of which:					
goodwill and intangible assets of disposal groups held for sale	*h*	146	(117)		29
retirement benefit assets	*g*	2,846			2,846
impairment allowances on assets held for sale		(703)			(703)
of which:					
IRB portfolios	*i*	(691)			(691)
Standardised portfolios	*k*	(12)			(12)
Total assets		2,692,538	(93,628)	220,314	2,819,224
Liabilities and equity					
Deposits by banks		107,429	(202)	51,296	158,523
Customer accounts		1,340,014	(652)	158,631	1,497,993
Trading liabilities		304,563	(131)	119	304,551
Financial liabilities designated at fair value		87,720	(12,437)		75,283
of which:					
term subordinated debt included in tier 2 capital	*m*	16,863			16,863
hybrid capital securities included in tier 1 capital	*j*	4,696			4,696
Debt securities in issue		119,461	(11,390)	1,888	109,959
Retirement benefit liabilities	*g*	3,905	(21)	52	3,936
Subordinated liabilities		29,479	3	2,953	32,435
of which:					
hybrid capital securities included in tier 1 capital.	*j*	2,828			2,828

	Ref				
perpetual subordinated debt included in tier 2 capital	*l*	2,778			2,778
term subordinated debt included in tier 2 capital	*m*	23,873			23,873
Other liabilities		516,838	(67,562)	5,375	454,651
of which:					
contingent liabilities and contractual commitments		301			301
of which:					
credit-related provisions on IRB portfolios	*i*	267			267
credit-related provisions on standardised portfolios	*k*	34			34
Total shareholders equity	*a*	175,242	(626)		174,616
of which:					
other equity instruments included in tier 1 capital	*c, j*	5,851			5,851
preference share premium included in tier 1 capital	*b*	1,405			1,405
Non-controlling interests	*d*	7,887	(610)		7,277
of which:					
non-cumulative preference shares issued by subsidiaries included in tier 1 capital	*e*	2,428			2,428
non-controlling interests included in tier 2 capital, cumulative preferred stock	*f*	300			300
non-controlling interests attributable to holders of ordinary shares in subsidiaries included in tier 2 capital	*f,m*	201			201
Total liabilities and equity		2,692,538	(93,628)	220,314	2,819,224

The references (a) (m) identify balance sheet components which are used in the calculation of regulatory capital on page 15.

11

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Structure of the regulatory group

HSBC s organisation is that of a financial holding company whose major subsidiaries are almost entirely wholly-owned banking entities. A simplified organisation chart showing the difference between the accounting and regulatory consolidation groups is included at Appendix I to this report.

Interests in 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 deducted from regulatory capital. The regulatory consolidation also excludes Special Purpose Entities (SPEs) where significant risk has been transferred to third parties. Exposures to these SPEs are risk-weighted as securitisation positions for regulatory purposes.

The capital invested in our insurance business that is deducted from regulatory capital was US$10.1bn at 31 December 2013 (2012: US$10.1bn)

of which US$9.1bn (2012: US$8.4bn) is shown as Capital invested in insurance and other entities in the column Deconsolidation of insurance/other entities in the table above. The remainder of the balance is related to regulatory adjustments to the insurance capital. The principal insurance entities comprising this balance are shown in table 3.

The deconsolidation of SPEs connected to securitisation activity and other entities mainly impacts the adjustments to Loans and advances to customers , Financial investments and Debt securities in issue . Table 3 lists the principal SPEs excluded from the regulatory consolidation with their total assets and total equity. Further details of the use of SPEs in the Group s securitisation activities are shown on page 550 in the *Annual Report and Accounts 2013* and on page 76 of this report.

The principal associates subject to proportional regulatory consolidation at 31 December 2013 are shown in table 3, representing 99% of our associates total assets as shown in table 2.

Table 3: Principal entities with a different regulatory and accounting scope of consolidation

	At 31 December 2013		
	Total assets US$m	Total equity US$m	Principal activities
Principal insurance entities excluded from the regulatory consolidation			
HSBC Life (UK) Ltd	**12,259**	**458**	Life insurance manufacturing
HSBC Assurances Vie (France)	**27,814**	**692**	Life insurance manufacturing
HSBC Life (International) Ltd	**28,785**	**2,070**	Life insurance manufacturing
Hang Seng Insurance Company Ltd	**12,289**	**1,142**	Life insurance manufacturing
HSBC Insurance (Singapore) Pte Ltd	**2,416**	**246**	Life insurance manufacturing
HSBC Life Insurance Company Ltd	**354**	**65**	Life insurance manufacturing
HSBC Amanah Takaful (Malaysia) SB	**338**	**29**	Life insurance manufacturing
HSBC Seguros (Brasil) S.A.	**743**	**441**	Life insurance manufacturing
HSBC Vida e Previdência (Brasil) S.A.	**5,154**	**122**	Life insurance manufacturing
HSBC Seguros de Vida (Argentina) S.A.	**201**	**53**	Life insurance manufacturing
HSBC Seguros de Retiro (Argentina) S.A.	**691**	**84**	Life insurance manufacturing

HSBC Seguros S.A. (Mexico)	**1,133**	**266**	Life insurance manufacturing
Principal SPEs excluded from the regulatory consolidation			
Regency Assets Ltd	**13,461**		Securitisation
Mazarin Funding Ltd	**7,431**		Securitisation
Barion Funding Ltd[1]	**3,769**	**(59)**	Securitisation
Malachite Funding Ltd[1]	**3,004**	**(22)**	Securitisation
Performance Trust[1]	**707**	**(3)**	Securitisation
Principal associates			
Bank of Communications Co., Limited (BoCom[2])	**946,332**	**67,609**	Banking services
The Saudi British Bank	**47,564**	**6,088**	Banking services

1 *These SPEs hold no or de minimis share capital. The negative equity represents net unrealised losses on unimpaired assets on their balance sheets and negative retained earnings.*
2 *Total assets and total equity as at 30 September 2013.*

Table 3 also aims to present as closely as possible the total assets and total equity, on a standalone IFRS basis, of the entities which are included in the Group consolidation on different

bases for accounting and regulatory purposes. The figures shown therefore include intra-Group balances.

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

For insurance entities, the figures shown exclude deferred acquisition cost assets as these are derecognised for consolidation purposes due to the recognition of present value of in-force long-term insurance business (PVIF) on long-term insurance contracts and investment contracts with discretionary participation features at Group level. The PVIF asset of US$5.3bn and the related deferred tax liability, however, are recognised at the consolidated level only, and are therefore also not included in the asset or equity positions for the standalone entities presented in table 3.

For associates, table 3 shows the total assets and total equity of the entity as a whole rather than HSBC s share in the entities balance sheets. Table 3 no longer includes Industrial Bank Co., Limited or Yantai Bank Co., Limited. On 7 January 2013, Industrial Bank Co., Limited completed a private placement of additional share capital to a number of third parties, which diluted the Group s equity holding. Similarly, in December 2013, Yantai Bank Co., Limited completed a private placement of additional share capital to a third party which diluted the Group s equity holding. As a result of these and other factors, the Group ceased to account for these investments as associates from the respective dates, and they are therefore no longer consolidated for either accounting or regulatory purposes, but treated as financial investments.

The change in the list of principal insurance entities excluded from the regulatory scope of consolidation is due to the sale of some of these entities. Bryant Park Funding LLC is no longer included in the list of SPEs excluded from the regulatory scope of consolidation, as it has ceased to operate as a securitisation SPE and significant risk is no longer transferred to third parties. It is now included in the regulatory and accounting scope of consolidation.

Measurement of regulatory exposures

The measurement of regulatory exposures is not directly comparable with the financial information presented in the *Annual Report and Accounts*, and this section sets out the main reasons for this.

The Pillar 3 Disclosures 2013 have been prepared in accordance with regulatory capital adequacy concepts and rules, while the *Annual Report and Accounts 2013* are prepared in accordance with IFRSs. The purpose of the regulatory balance sheet is to provide a point in time value of all on balance sheet assets. The regulatory

exposure value includes an estimation of risk, and is expressed as the amount expected to be outstanding if and when the counterparty defaults.

The difference between total assets on the regulatory balance sheet of US$2,757bn as shown in table 2 above and the credit risk exposure values (including CCR) of US$2,304bn as shown in table 7 below is principally attributable to the following factors:

Credit risk and CCR exposures

Various assets on the regulatory balance sheet, such as intangible assets and goodwill, are excluded from the calculation of the credit risk exposure value as they are deducted from capital.

The regulatory balances are adjusted for the effect of the differences in the basis for regulatory and accounting netting, and in the treatment of financial collateral.

Credit risk exposures only

When assessing credit risk exposures within the regulatory balance sheet, the Basel approach used to report the asset in question determines the calculation method for EAD. Using the Basel standardised (STD) approach, the regulatory exposure value is based on the regulatory balance sheet amount, applying a number of further regulatory adjustments. Using IRB approaches, the regulatory EAD is either determined using supervisory (Foundation) or internally modelled (Advanced) methods.

EAD takes account of off balance sheet items, such as the undrawn portion of committed facilities, various trade finance commitments and guarantees, by applying credit conversion factors (CCF) to these items.

Assets on the regulatory balance sheet are net of impairment. EAD, however, is only reduced for individual impairments under the STD approach. Collective impairments under the STD approach, and all impairments under the IRB approach, are not used to reduce the EAD amount.

CCR exposures only

For regulatory purposes, trading book items and derivatives and securities financing items, in the banking book are treated under the rules for CCR which is shown as a separate line item in table 7. CCR exposures express the risk that the counterparty to a transaction may default before completing the satisfactory settlement of the transaction. See table 34 for a comparison of derivative accounting balances and counterparty credit risk exposure for derivatives.

CCR excludes fully collateralised transactions with central counterparties as such exposures are set to nil for regulatory purposes.

HSBC uses the mark-to-market method and the internal model method (IMM) approach to calculate CCR EAD. Under the mark-to-market method EAD is based on the balance sheet value of the instrument plus an add-on for potential future exposure. Under the IMM approach modelled exposure value replaces the fair value on the balance sheet.

Moreover, regulatory exposure classes are based on different criteria to accounting asset types and are therefore not comparable on a line by line basis.

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Capital and Risk

Capital management

Our approach to capital management is driven by our strategic and organisational requirements, taking into account the regulatory, economic and commercial environment in which we operate. We aim to maintain a strong capital base to support the risks inherent in our business and invest in accordance with our six filters framework, exceeding both consolidated and local regulatory capital requirements at all times.

Our capital management process culminates in the annual Group capital plan, which is approved by the Board. HSBC Holdings is the primary provider of equity capital to its subsidiaries and also provides them with non-equity capital where necessary. These investments are substantially funded by HSBC Holdings issuance of equity and non-equity capital and by profit retention. As part of its capital management process, HSBC Holdings seeks to maintain a balance between the composition of its capital and its investment in subsidiaries.

Each subsidiary manages its own capital to support its planned business growth and meet its local regulatory requirements within the context of the Group capital plan. Capital generated by subsidiaries in excess of planned requirements is returned to HSBC Holdings, normally by way of dividends, in accordance with the Group s capital plan. During 2012 and 2013, none of the Group s subsidiaries experienced significant restrictions on paying dividends or repaying loans and advances. The ability of subsidiaries to pay dividends or advance monies to HSBC Holdings depends on, among other things, their respective local regulatory capital and banking requirements, statutory reserves, and financial and operating performance.

At 31 December 2013, there were no known material impediments to the prompt payment of dividends by our subsidiaries or repayment of intra-Group loans and advances when due. None of our subsidiaries which are excluded from the regulatory consolidation has capital resources below their minimum regulatory requirement.

For further details of our approach to capital management, please see page 319 of the Annual Report and Accounts 2013.

Regulatory capital

For regulatory purposes, our capital base is divided into three main categories, namely core tier 1, other tier 1 and tier 2, depending on the degree of permanency and loss absorbency exhibited.

Categories of capital:

- core tier 1 capital comprises shareholders equity and related non-controlling interests. The book values of goodwill and intangible assets are deducted from core tier 1 capital, and other regulatory adjustments are made for items reflected in shareholders equity which are treated differently for the purposes of capital adequacy;

qualifying capital instruments such as non-cumulative perpetual preference shares and hybrid capital securities are included in other tier 1 capital; and

tier 2 capital comprises qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available for sale. Tier 2 capital also includes reserves arising from the revaluation of properties.

To ensure the overall quality of the capital base, the PRA s rules set restrictions on the amount of hybrid capital instruments that can be included in tier 1 capital relative to core tier 1 capital, and limits overall tier 2 capital to no more than tier 1 capital. We complied with the PRA s capital adequacy requirements throughout 2012 and 2013.

For a table of the movement in total regulatory capital during the year to 31 December 2013, please see page 304 of the Annual Report and Accounts 2013.

All capital securities included in the capital base of HSBC have been issued in accordance with the rules and guidance in the PRA s General Prudential Sourcebook (GENPRU). The main features of capital securities issued by the Group, categorised by tier 1 and tier 2 capital, are set out on pages 528, 529, 544 and 545 of the *Annual Report and Accounts 2013*. The values disclosed there are the IFRSs balance sheet carrying amounts, however, not the amounts that these instruments contribute to regulatory capital. For example, the IFRSs accounting and the regulatory treatments differ in their approaches to issuance costs or regulatory amortisation. The composition of capital under the current regulatory requirement is provided in the table below. The alphabetic references link back to table 2: Reconciliation of balance sheets financial accounting to regulatory scope of consolidation , which shows where these items are presented in the respective balance sheets. Not all items are reconcilable, due to regulatory adjustments that are applied, for example to non-core capital instruments before they can be included in the Group s regulatory capital base.

Table of Contents

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Table 4: Composition of regulatory capital

		At 31 December	
		2013	2012
	Ref[1]	**US$m**	US$m
Tier 1 capital			
Shareholders equity		**173,449**	167,360
Shareholders equity per balance sheet[2]	*a*	**181,871**	175,242
Preference share premium	*b*	**(1,405)**	(1,405)
Other equity instruments	*c*	**(5,851)**	(5,851)
Deconsolidation of special purpose entities[3]	*a*	**(1,166)**	(626)
Non-controlling interests		**4,955**	4,348
Non-controlling interests per balance sheet d		**8,588**	7,887
Preference share non-controlling interests e		**(2,388)**	(2,428)
Non-controlling interests transferred to tier 2 capital	*f*	**(488)**	(501)
Non-controlling interests in deconsolidated subsidiaries d		**(757)**	(610)
Regulatory adjustments to the accounting basis		**480**	(2,437)
Unrealised losses on available-for-sale debt securities[4]		**2,595**	1,223
Own credit spread		**1,037**	112
Defined benefit pension fund adjustment[5]	*g*	**(518)**	(469)
Reserves arising from revaluation of property and unrealised gains on available-for-sale equities		**(2,755)**	(3,290)
Cash flow hedging reserve		**121**	(13)
Deductions		**(29,833)**	(30,482)
Goodwill and intangible assets	*h*	**(25,198)**	(25,733)
50% of securitisation positions		**(1,684)**	(1,776)
50% of tax credit adjustment for expected losses		**151**	111
50% of excess of expected losses over impairment allowances	*i*	**(3,102)**	(3,084)
Core tier 1 capital		**149,051**	138,789
Other tier 1 capital before deductions		**16,110**	17,301
Preference share premium	*b*	**1,405**	1,405
Preference share non-controlling interests e		**2,388**	2,428
Hybrid capital securities	*j*	**12,317**	13,468
Deductions		**(7,006)**	(5,042)
Unconsolidated investments[6]		**(7,157)**	(5,153)
50% of tax credit adjustment for expected losses		**151**	111
Tier 1 capital		**158,155**	151,048
Tier 2 capital			
Total qualifying tier 2 capital before deductions		**47,812**	48,231
Reserves arising from revaluation of property and unrealised gains on available-for-sale equities		**2,755**	3,290
Collective impairment allowances	*k*	**2,616**	2,717
Perpetual subordinated debt	*l*	**2,777**	2,778
Term subordinated debt	*m*	**39,364**	39,146

Non-controlling interests in tier 2 capital	*f*	**300**	300
Total deductions other than from tier 1 capital		**(11,958)**	(18,473)
Unconsolidated investments[6]		**(7,157)**	(13,604)
50% of securitisation positions		**(1,684)**	(1,776)
50% of excess of expected losses over impairment allowances	*i*	**(3,102)**	(3,084)
Other deductions		**(15)**	(9)
Total regulatory capital		**194,009**	180,806

1 *The references (a) to (m) refer to those in the reconciliation of balance sheets in table 2 on page 10.*
2 *Includes externally verified profits for the year ended 31 December 2013.*
3 *Mainly comprises unrealised gains/losses on available-for-sale debt securities related to SPEs.*
4 *Under PRA rules, unrealised gains/losses on debt securities net of tax must be excluded from capital resources.*
5 *Under PRA rules, any defined benefit asset is derecognised and a defined benefit liability may be substituted with the additional funding that will be paid into the relevant schemes over the following five-year period.*
6 *Mainly comprise investments in insurance entities. Due to the expiry of the transitional provision, with effect from 1 January 2013, material insurance holding companies acquired prior to 20 July 2006 are deducted 50% from tier 1 and 50% from total capital at 31 December 2013.*

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Regulatory impact of management actions (2012 only)

	At 31 December			
2012	Risk-weighted assets	Core tier 1 capital	Tier 1 capital	Total regulatory capital
Reported capital ratios before management actions		12.3%	13.4%	16.1%
Reported totals (US$m)	1,123,943	138,789	151,048	180,806
Management actions completed in 2013 (US$m)				
Dilution of our shareholding in Industrial Bank and the subsequent change in accounting treatment	(38,073)	981	(423)	(1,827)
Completion of the second tranche of the sale of Ping An		553	4,637	7,984
Estimated total after management actions completed in 2013 (US$m)	1,085,870	140,323	155,262	186,963
Estimated capital ratios after management actions completed in 2013		12.9%	14.3%	17.2%

Calculation of capital requirements

This and the following section describe our Pillar 1 capital requirements, with a high-level view of the related RWAs, the scope of the Group s Pillar 1 permissions and our application of the Pillar 2 framework.

Pillar 1 covers the minimum capital resources requirements for credit risk, market risk and operational risk. These requirements are expressed in terms of RWAs. Where they are not separately

shown, counterparty credit risk and securitisation requirements fall within credit risk.

Tables 5, 6 and 7 set out the distribution of our Pillar 1 RWAs by risk type, global business, geography and modelling approach.

Further details of the Group s risk profile arising from the business activities of our global businesses may be found on page 37 of the Annual Report and Accounts 2013.

Table 5: Risk-weighted assets by global business and geographical region

Europe	Hong Kong	Rest of Asia-	MENA	North America	Latin America	Total RWAs	Capital required

			Pacific					
	US$bn	**US$bn**	**US$bn**	**US$bn**	**US$bn**	**US$bn**	**US$bn**	**US$bn**
At 31 December 2013								
Retail Banking and Wealth Management	**45.9**	**19.1**	**32.8**	**7.9**	**103.8**	**24.0**	**233.5**	**18.7**
Commercial Banking	**90.5**	**47.8**	**144.6**	**25.2**	**50.7**	**32.9**	**391.7**	**31.3**
Global Banking and Markets[1]	**149.2**	**61.2**	**103.7**	**27.8**	**62.1**	**32.2**	**422.3**	**33.8**
Global Private Banking	**13.1**	**2.3**	**1.3**	**0.4**	**4.4**	**0.2**	**21.7**	**1.7**
Other[2]	**1.4**	**7.9**	**10.0**	**1.2**	**2.8**	**0.2**	**23.5**	**1.9**
	300.1	**138.3**	**292.4**	**62.5**	**223.8**	**89.5**	**1,092.7**	**87.4**
At 31 December 2012								
Retail Banking and Wealth Management	49.4	18.6	33.0	7.6	140.7	27.3	276.6	22.1
Commercial Banking	88.7	41.7	155.9	27.6	46.5	36.6	397.0	31.8
Global Banking and Markets[1]	158.5	42.5	102.3	24.8	59.2	33.8	403.1	32.3
Global Private Banking	13.3	2.2	1.3	0.4	4.3	0.2	21.7	1.8
Other[2]	4.8	6.9	9.7	1.8	2.3		25.5	2.0
	314.7	111.9	302.2	62.2	253.0	97.9	1,123.9	90.0

1 *RWAs are non-additive across geographical regions due to market risk diversification effects within the Group.*

2 *Includes the results of certain property transactions, unallocated investment activities, centrally held investment companies, movements in fair value of own debt, central support costs with associated recoveries, HSBC s holding company and financing operations.*

16

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Table 6: Risk-weighted assets by risk type and geographical region

	Europe US$bn	Hong Kong US$bn	Rest of Asia-Pacific US$bn	MENA US$bn	North America US$bn	Latin America US$bn	Total RWAs US$bn	Capital required US$bn
At 31 December 2013								
Credit risk	**211.4**	**102.8**	**246.0**	**55.0**	**184.2**	**64.9**	**864.3**	**69.1**
Counterparty credit risk	**23.0**	**5.2**	**5.7**	**0.7**	**8.5**	**2.7**	**45.8**	**3.7**
Market risk[1]	**30.6**	**13.5**	**13.4**	**0.8**	**13.9**	**5.1**	**63.4**	**5.1**
Operational risk	**35.1**	**16.8**	**27.3**	**6.0**	**17.2**	**16.8**	**119.2**	**9.5**
	300.1	**138.3**	**292.4**	**62.5**	**223.8**	**89.5**	**1,092.7**	**87.4**
At 31 December 2012								
Credit risk	222.9	82.9	260.0	54.1	204.2	74.3	898.4	71.9
Counterparty credit risk	22.5	5.3	5.9	1.0	11.3	2.3	48.3	3.9
Market risk[1]	35.0	8.3	10.2	1.2	13.8	4.4	54.9	4.4
Operational risk	34.3	15.4	26.1	5.9	23.7	16.9	122.3	9.8
	314.7	111.9	302.2	62.2	253.0	97.9	1,123.9	90.0

1 *RWAs are non-additive across geographical regions due to market risk diversification effects within the Group.*

RWA planning

Pre-tax return on RWAs is an operational metric by which the global businesses are managed on a day-to-day basis. The metric combines return on equity and regulatory capital efficiency objectives. In addition, RWA targets for our global businesses and regions are established and approved through the Group s annual planning process.

Business performance against the targets is monitored through reporting to the HSBC Holdings Asset and Liability Committee. The management of capital deductions is also addressed in the RWA monitoring framework through notional charges for these items, enabling a more holistic approach to performance measurement. A range of analysis is employed in the RWA monitoring framework to identify the key drivers of movements in the position, such as book size and book quality. Particular attention is paid to identifying and segmenting items within the day-to-day control of the business and those items that are driven by changes in risk models or regulatory methodology.

Movements in RWAs in 2013

RWAs reduced by US$31.2bn to US$1,092.7bn mainly due to the reclassification of Industrial Bank from an associate to a financial investment and the continued run-off of the US CML portfolio. These reductions were partly offset by several other drivers discussed below, including implementation of a 45% floor on loss-given-default for sovereign exposures as required by the PRA, and business growth.

Credit risk RWAs

Credit risk RWAs reduced by US$34.1bn, of which US$7.3bn was due to foreign exchange movements, while the remaining US$26.8bn was due to a range of drivers across the regions and global businesses. The commentary below is discussed exclusive of foreign currency translation effects.

Europe

In Europe, credit risk RWAs reduced by US$14.9bn. Credit quality changes for securitisation exposures in Global Banking and Markets (GB&M) reduced RWAs by US$4.5bn and partly reflects the effect of exposures moving from RWAs to capital deductions. Reductions in securitisation exposures resulted in a decline in RWAs of US$1.4bn, reflecting sales and amortisation of assets in the GB&M legacy credit portfolio. Income producing real estate (IPRE) portfolios in CMB, Global Private Banking (GPB) and GB&M were moved from the standardised approach to the IRB slotting approach, with a net reduction in RWAs of US$1.7bn. As a result of business restructuring, a corporate portfolio in GB&M was moved to the IRB approach, and a retail approach was applied to a portfolio of small and medium-sized enterprise (SME) customers in CMB, resulting in reductions in RWAs of US$1.4bn and US$0.8bn respectively.

A decrease in corporate exposure reduced RWAs by US$2.5bn. The implementation of a new corporate exposure model with lower credit conversion factors that are more reflective of

17

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

historical experience reduced RWAs by US$2.3bn in GB&M. A US$5.3bn RWA management overlay was applied for corporate exposures in CMB and GB&M, in response to increased loss rates and in advance of model recalibration. This was partially offset by favourable movements in corporate and institutional portfolio quality in GB&M with a reduction in RWAs of US$3.2bn. The application of the 45% floor for loss-given-default for sovereign exposures increased RWAs by US$2.6bn, mainly in GB&M.

RBWM RWAs reduced by US$1.7bn on retail mortgage and credit card portfolios, mainly reflecting favourable changes in customer risk and the risk distribution in these portfolios. A further reduction of US$1.4bn was a result of the sale of the HFC Bank UK secured loan portfolio.

Hong Kong and Rest of Asia-Pacific

In Hong Kong, credit risk RWAs increased US$19.9bn, while in Rest of Asia-Pacific credit risk RWAs reduced by US$12.8bn.

In Rest of Asia-Pacific, the reduction in RWAs was primarily due to the reclassification of Industrial Bank from an associate to a financial investment. As a result, the holding was removed from the regulatory consolidation for RWAs and the investment was deducted from capital, resulting in a year-on-year reduction in RWAs of US$39.2bn. This was partly offset by loan growth in the Bank of Communications, increasing RWAs by US$14.5bn.

In Hong Kong and Rest of Asia-Pacific, business growth for CMB and GB&M was mainly driven by corporate term and trade-related lending and trade finance business resulting in an RWA increase of US$12.6bn, with a further increase of US$1.8bn relating to higher institutional exposures. In Hong Kong, an RWA increase of US$4.7bn was attributable to adverse movements in customer credit standing for GB&M and CMB corporate customers, partly offset by favourable shifts in loss-given-default metrics and the risk distribution of the portfolio.

In Hong Kong and Rest of Asia-Pacific, the application of the 45% floor for loss-given-default for sovereign exposures increased RWAs by US$6.2bn mainly in GB&M, while increases in sovereign exposure increased RWAs by a further US$3.2bn. Adverse changes in the internal sovereign rating for Hong Kong increased RWAs by US$1.3bn in GB&M, although this was almost fully offset by favourable shifts in sovereign portfolio quality from a range of other smaller drivers. Corporate exposures

in CMB and GB&M were identified which did not meet full modelling requirements and these were moved to the standardised approach, with a net increase in RWAs of US$0.7bn.

In Hong Kong, credit card and unsecured lending portfolio growth resulted in an increase in RWAs of US$1.2bn in RBWM, while improvements in the quality of the credit card and unsecured lending portfolio reduced RWAs by US$0.5bn. In Rest of Asia-Pacific, residential mortgage growth increased RWAs by US$1.0bn in RBWM.

Middle East and North Africa

In Middle East and North Africa, credit risk RWAs increased by US$1.7bn. Adverse changes in the internal sovereign rating for Egypt increased RWAs by US$1.9bn in GB&M, although this was partially offset by favourable shifts in sovereign portfolio quality reducing RWAs by US$0.4bn in the region. There were reductions in RWAs of US$2.2bn for CMB in the UAE and Oman from lower lending volumes, although this was partly offset by corporate RWA growth in GB&M of US$0.5bn. Growth in The Saudi British Bank associate increased RWAs by US$1.1bn.

North America

In North America, credit risk RWAs reduced by US$18.0bn. RBWM balances were managed down during the period, reducing RWAs by US$14.0bn, primarily due to continued run-off of the US CML retail mortgage portfolio. In line with our objectives to accelerate the run-off of

US CML there have been sales of non-real estate and personal homeowner loans with an RWA reduction of US$8.2bn. Additional sales of defaulted mortgage exposures, which did not accrue RWAs, also had a beneficial impact on the capital position through lower deductions for regulatory expected losses.

In RBWM, further reductions in RWAs of US$4.2bn were from movements in credit quality for retail mortgages, mainly in US CML as a result of accounts moving into default. This was accompanied by a rise in regulatory expected losses, leading to higher deductions from capital.

Commercial real estate portfolios in CMB and GB&M in the US were moved from IRB to the standardised approach as required by the PRA, increasing RWAs by US$3.6bn. Corporate lending growth in CMB resulted in an increase in RWAs of US$3.2bn, while reductions in exposures to institutions reduced RWAs in GB&M by US$1.1bn. Favourable movements in customer credit standing

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

for GB&M and CMB corporate customers reduced RWAs by US$3.5bn.

The application of the 45% floor for loss-given-default for sovereign exposures increased RWAs by US$10.2bn in GB&M. This was partially offset by favourable changes in the internal sovereign rating for the US, reducing RWAs by US$3.6bn in GB&M.

Latin America

In Latin America, credit risk RWAs reduced by US$2.7bn. The disposal of operations in Panama, Peru and Paraguay reduced RWAs by US$7.9bn. Corporate term lending and trade finance growth in GB&M and CMB in Brazil increased RWAs by US$3.7bn.

Counterparty credit risk RWAs

CCR RWAs calculated on the IRB approach reduced by US$3.5bn. Book quality movements drove a reduction in RWAs of US$2.7bn due to improvement in the credit standing of counterparties, mainly in North America. The reduction in book size of US$0.9bn was due to lower exposures across most regions as trades matured and volumes reduced.

CCR RWAs on the standardised approach increased by US$0.9bn, mainly due to higher balance sheet exposures on foreign exchange derivatives with corporate counterparties in Brazil.

Market risk RWAs

Market risk RWAs increased by US$8.5bn, mainly due to model updates in relation to the incremental risk charge (IRC) which increased RWAs by US$17.3bn.

In 2013, the IRC model was updated to account more explicitly for stressed conditions. Key input

parameters were calibrated to a stressed period and further granularity in parameters were introduced to better represent the risk profile. This has led to a one time increase in the IRC requirement which is reflected in the current year. As part of the model oversight, the IRC model will be periodically recalibrated to accurately capture the risk profile in a stressed environment.

Further RWA increases of US$4.6bn were mainly due to changes in stressed Value at Risk (VaR) period and internal methodology updates relating to a change in the basis of consolidation for modelled market risk charges as a result of clarification of the regulatory rules.

These movements were partly offset by reductions in positions sensitive to the IRC and changes in the shape of the trading portfolio due to defensive positions taken by the Equity and Foreign Exchange businesses in GB&M, leading to a lower stressed VAR and VAR, reducing RWAs by US$14.5bn.

Operational risk RWAs

The reduction in Operational Risk RWAs for the Group of US$3.1bn was driven by the decrease in North America of US$6.4bn, mainly due to the acceleration of the amortisation of the operational risk RWAs for the US CRS portfolio disposed of in May 2012. This was partly offset by RWA growth in Hong Kong of US$1.5bn and Rest of Asia Pacific of US$1.2bn due to a higher three-year average operating income from higher loans and advances.

Scope of Basel Pillar 1 approaches

The scope of permissible Basel approaches, and those that HSBC has adopted, are described below. For further information on the approaches used, see page 31 for credit risk, page 69 for CCR, page 81 for market risk and page 84 for operational risk.

Table of Contents

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Risk category	Scope of permissible approaches	Approach adopted by HSBC
Credit risk	Basel II applies three approaches of increasing sophistication to the calculation of Pillar 1 credit risk capital requirements. The most basic level, the standardised approach, 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 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 EAD and LGD to standard supervisory parameters. Finally, the IRB advanced approach allows banks to use their own internal assessment in both determining PD and quantifying EAD and LGD.	For consolidated Group reporting, we have adopted the IRB advanced approach for the majority of our business. Some portfolios remain on the standardised or foundation approaches under Basel II, pending the issuance of local regulations or model approval, or under exemptions from IRB treatment. Further information on our IRB roll-out plan may be found on page 41.
Counterparty credit risk	Three approaches to calculating counterparty credit risk and determining exposure values are defined by Basel II: standardised, mark-to-market and 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 aim is to increase the proportion of positions on IMM over time.
Equity	Equity exposures can be assessed under standardised or IRB approaches.	Whilst some equity exposures are reported locally under the IRB simple risk weight approach, for Group reporting purposes all equity exposures are treated under the standardised approach.
Securitisation	Basel II specifies two methods for calculating credit risk requirements for securitisation positions in the non-trading book: the standardised approach and the IRB approach, which incorporates the Ratings Based Approach (RBM), the Internal Assessment Approach (IAA) and the Supervisory Formula Method (SFM).	For the majority of the securitisation non-trading book positions we use the IRB approach, and within this principally the RBM, with lesser amounts on IAA and SFM. We also use the standardised approach for an immaterial amount of trading book positions.
Market risk	Market risk capital requirements can be determined under either the standard rules or the internal models approach. The latter involves the use of internal VAR models to measure market risks and determine the appropriate capital requirement.	The market risk capital requirement is measured using internal market risk models, where approved by the PRA, or the PRA standard rules. Our internal market risk models comprise VAR, stressed VAR, IRC and, in respect of correlation trading, the CRM.

	The IRC and comprehensive risk measure (CRM) also apply.	
Operational risk	Basel II allows for firms to calculate their operational risk capital requirement under the basic indicator approach, the standardised approach or the advanced measurement approach.	We have historically adopted and currently use the standardised approach in determining our operational risk capital requirement. We are in the process of developing and implementing an advanced measurement approach (AMA).

20

Table of Contents

HSBC HOLDINGS PLC

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Table 7: Credit risk and counterparty credit risk by Basel approach and exposure class

	Total	Standardised		Foundation		Advanced		Total	Capital
	EAD	EAD	RWAs	EAD	RWAs	EAD	RWAs	RWAs	required
	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn
At 31 December 2013									
Credit risk	**2,160.1**	**667.7**	**329.5**	**23.6**	**13.6**	**1,468.8**	**521.2**	**864.3**	**69.1**
Counterparty credit risk	**143.4**	**10.7**	**3.6**	**3.1**	**1.5**	**129.6**	**40.7**	**45.8**	**3.7**
	2,303.5	**678.4**	**333.1**	**26.7**	**15.1**	**1,598.4**	**561.9**	**910.1**	**72.8**
Central governments and central banks	**572.4**	**226.5**	**0.7**			**345.9**	**53.9**	**54.6**	**4.4**
Institutions	**230.7**	**35.7**	**12.2**			**195.0**	**41.5**	**53.7**	**4.3**
Corporates	**821.3**	**225.5**	**205.6**	**26.7**	**15.1**	**569.1**	**306.0**	**526.7**	**42.1**
Retail									
Secured on real estate property	**361.1**	**50.4**	**28.4**			**310.7**	**105.4**	**133.8**	**10.7**
Qualifying revolving retail	**66.9**					**66.9**	**15.4**	**15.4**	**1.2**
SMEs	**18.6**					**18.6**	**8.9**	**8.9**	**0.7**
Other retail	**94.5**	**47.7**	**36.1**			**46.8**	**11.0**	**47.1**	**3.8**
Equity	**3.3**	**3.3**	**3.5**					**3.5**	**0.3**
Securitisation positions	**45.4**					**45.4**	**19.8**	**19.8**	**1.6**
Other	**89.3**	**89.3**	**46.6**					**46.6**	**3.7**
	2,303.5	**678.4**	**333.1**	**26.7**	**15.1**	**1,598.4**	**561.9**	**910.1**	**72.8**
Market risk								**63.4**	**5.1**
Operational risk								**119.2**	**9.5**
								1,092.7	**87.4**
At 31 December 2012									
Credit risk	2,170.9	681.5	374.5	19.4	10.3	1,470.0	513.6	898.4	71.9
Counterparty credit risk	141.4	5.8	2.6	3.5	1.8	132.1	43.9	48.3	3.9
	2,312.3	687.3	377.1	22.9	12.1	1,602.1	557.5	946.7	75.8
Central governments and central banks	545.1	179.6	0.9			365.5	37.7	38.6	3.1
Institutions	258.0	58.0	19.4			200.0	43.1	62.5	5.0
Corporates	813.1	257.6	239.9	22.9	12.1	532.6	278.5	530.5	42.5
Retail									
Secured on real estate property	362.7	45.3	24.0			317.4	130.8	154.8	12.4
Qualifying revolving retail	64.0					64.0	16.2	16.2	1.3
SMEs	13.1					13.1	6.8	6.8	0.5
Other retail	113.0	52.9	40.1			60.1	17.2	57.3	4.6
Equity	3.1	2.8	2.8			0.3	0.9	3.7	0.3
Securitisation positions	49.1					49.1	26.3	26.3	2.1
Other	91.1	91.1	50.0					50.0	4.0
	2,312.3	687.3	377.1	22.9	12.1	1,602.1	557.5	946.7	75.8
Market risk								54.9	4.4
Operational risk								122.3	9.8
								1,123.9	90.0

Key points

The reclassification of Industrial Bank from an associate to a financial investment, removing the requirement for proportional regulatory consolidation, was the primary driver of the EAD and RWA movements in the corporates, institutions and other retail exposure classes under the standardised approach. These reductions were partially offset by growth in Bank of Communications.

Central governments and central bank exposures growths under the standardised approach was mainly due to higher placements with the Bank of England and holdings of UK gilts.

Higher RWAs for central government and central bank exposures under the IRB advanced approach were due to the application of a loss-given-default floor of 45% for sovereign exposures with an impact of US$19bn on implementation and, to a lesser extent, adverse internal rating changes for sovereign exposures in the Middle East and North Africa and Hong Kong.

Term lending, revolving credit products and trade finance business growth in Rest of Asia-Pacific, Hong Kong and North America were the main drivers of EAD and RWA movements for corporates under the IRB advanced approach.

Continued run-off and sale of loans for the US CML portfolio were the key drivers of RWA movements in the IRB advanced retail secured on real estate property exposure class.

Business restructuring for a portfolio of SME exposures in Europe caused a change from the corporate to the retail SME treatment under the IRB advanced approach, increasing EAD and RWA for this exposure class.

Sale of non-real estate loans for the US CML portfolio has reduced the average exposure of other retail under the advanced approach.

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

Pillar 2 and ICAAP

Pillar 2

The processes of internal capital adequacy assessment and supervisory review, known as Pillar 2, lead to final determination by the PRA of Individual Capital Guidance (ICG) and any Capital Planning Buffer (CPB) that may be required.

Within Pillar 2, Pillar 2A considers, in addition to the minimum capital requirements for Pillar 1 risks described above, any supplementary requirements for those risks and in addition any requirements for risk categories not captured by Pillar 1. Such categories include principally: pension risk, insurance risk, non-trading book interest rate risk, structural foreign exchange risk, and concentration risks. Pillar 2A also estimates capital needed to compensate for any shortcomings in management, governance or controls, and to guard against unexpected losses while these deficiencies are addressed.

Pillar 2B considers the capital buffer a firm would require in order to remain above its ICG in adverse circumstances that may be largely outside the firm s normal and direct control, for example during a period of severe but plausible downturn stress, when asset values and the firm s capital surplus may become strained. This is quantified via any CPB requirement the PRA may consider necessary. The assessment of this is informed by stress tests and a rounded judgement of a firm s business model, also taking into account a firm s options and capacity to protect its capital position under stress, for instance through capital generation.

Complementing the above, in 2013 the PRA set a forward-looking CET1 target capital ratio for HSBC, in order to manage our transition to the Basel III capital requirements under CRD IV.

Internal capital adequacy assessment

Through the Internal Capital Adequacy Assessment Process (ICAAP), Group Management Board (GMB) examines the Group s risk profile from both regulatory and economic capital viewpoints, aiming to ensure that capital resources:

- remain sufficient to support our risk profile and outstanding commitments;
- exceed current regulatory requirements, and HSBC is well placed to meet those expected in the future;
- allow the bank to remain adequately capitalised in the event of a severe economic downturn stress scenario; and
- remain consistent with our strategic and operational goals and our shareholder and investor expectations.

The minimum regulatory capital that we are required to hold is determined by the rules and guidance established by the PRA for the consolidated Group and by local regulators for individual Group companies. These capital requirements are a primary influence shaping the business planning process, in which RWA targets are established for our global businesses in accordance with the Group s strategic direction and risk appetite.

Economic capital is the internally calculated capital requirement which we deem necessary to support the risks to which we are exposed. The economic capital assessment is a more risk-sensitive measure than the regulatory minimum, as it covers a wider range of risks and takes account of the substantial diversification of risk accruing from our operations. Both the regulatory and the economic capital assessments rely upon the

use of models that are integrated into our management of risk. Our economic capital models are calibrated to quantify the level of capital that is sufficient to absorb potential losses over a one-year time horizon to a 99.95% level of confidence for our banking activities, and to a 99.5% level of confidence for our insurance activities and pension risks.

Preserving our strong capital position remains a priority, and the level of integration of our risk and capital management helps to optimise our response to business demand for regulatory and economic capital. Risks that are explicitly assessed through economic capital, and those that are not, are compared in Appendix II.

Top and emerging risks

A list of our top and emerging risks is regularly evaluated to assess the impact on our core capital position. This evaluation extends to a number of risks not technically within the scope of our top and emerging risks, but which are identified as presenting risks to capital due to their potential to impact the Group s risk-weighted asset and/or capital supply position. The downside or upside scenarios are assessed against the Group s capital management objectives and mitigating actions assigned to senior management as necessary.

Stress testing

Our stress testing and scenario analysis programme is central to the monitoring of top and emerging risks, helping us to understand the sensitivities of the core assumptions in our capital plans to the adverse effect

of extreme but plausible events. Stress testing allows us to formulate our response and mitigate risk in advance of actual conditions exhibiting the stresses identified in the scenarios.

Market stresses which occurred throughout the financial system in recent years have been used to inform our capital planning process and enhance the stress scenarios we employ. In addition to our internal stress tests, others are undertaken at the request of regulators using their prescribed assumptions, and by the regulators themselves. We take into account the results of all such stress testing when assessing our internal and regulatory capital requirements.

The Stress Testing and Economic Capital Committee, which reports to the Risk Management Meeting (RMM) exercises governance, oversight and approval authority over ICAAP and economic capital models.

The Group is subject to supervisory stress testing in many jurisdictions. Supervisory requirements are increasing in frequency and in the granularity with which results are required. These exercises include the programmes of the PRA, the Federal Reserve, the EBA, the European Central Bank (ECB) and the Hong Kong Monetary Authority, as well as stress tests undertaken in many other jurisdictions.

The Group is taking part in the Bank of England concurrent stress test exercise in 2014. This programme will include common base and stress scenarios applied across all major UK banks. The exercise will be supported by a complementary programme of data provision to the Bank of England under its Firm Data Submission Framework. At the time of writing, the PRA is considering a range of disclosure options related to the stress test exercise.

HSBC North America Holdings, Inc. (HNAH) and HSBC Bank USA NA (HBUS) are subject to the Comprehensive Capital Analysis and Review (CCAR) and Dodd-Frank Stress Testing programmes of the Federal Reserve and the Office of the Comptroller of the Currency. HNAH and HBUS made submissions under these programmes on 6 January 2014. Disclosure by the Federal Reserve and by HNAH and HBUS of the results of these exercises will be made in March 2014.

HSBC will be included in the next round of European stress test exercises, scheduled for 2014. HSBC France and HSBC Malta will participate in the ECB s Asset Quality Review, run as part of the ECB s comprehensive assessment prior to inception of the Single Supervisory Mechanism. They will then be subject to the ECB s stress testing

process. The Group will take part in the related exercise run by the EBA. Disclosures of the results of these exercises are planned in late 2014.

Further details of the Group s stress testing activities, areas of special interest and top and emerging risks are given on pages 139,147 and 141 of the Annual Report and Accounts 2013, respectively.

Basel III implementation and CRD IV

(Unaudited)

In June 2013, the European Commission published the final Regulation and Directive, known collectively as CRD IV, to give effect to the Basel III framework in the EU. This came into effect on 1 January 2014.

In December 2013, the PRA issued its final rules on CRD IV in PS 7/13, which transposes the various areas of national discretion within the final CRD IV legislation in the UK.

Despite these final PRA rules further PRA consultations are due in 2014, for CRD IV capital buffers and Pillar 2.

In addition, many technical standards and guidelines have been issued by the EBA in draft form for consultation or are pending publication in 2014. These must be adopted by the European Commission to become legally enforceable, which provides further uncertainty as to the capital requirements under CRD IV.

Following publication of the final CRD IV rules and UK national discretions, in order to provide transparency to the way we manage our transition to Basel III under CRD IV, we set out information for investors on the estimated effects of these rules on our CET1 capital position in table 8: Composition of regulatory capital on an estimated CRD IV end point basis and Year 1 transitional basis on page 24.

This is supplemented by table 9: Reconciliation of current rules to CRD IV end point rules which presents a reconciliation of our reported core tier 1 capital and RWAs to our estimated CET1 end point capital and estimated RWAs at 31 December 2013. The position at 31 December 2013 is presented in comparison with that at 31 December 2012, where the estimated effect was based on the earlier July 2011 draft CRD IV text. The capital position is presented on an end-point definition of CET1 capital, applying all deductions and regulatory adjustments to CET1 capital in full, as they would apply at the end of the transitional period.

The tables quantify the capital and RWA impacts known at this time and are based on

Capital and Risk Management Pillar 3 Disclosures at 31 December 2013 (continued)

our interpretation of the final CRD IV regulation and final rules issued by PRA, as supplemented by regulatory guidance.

The effects of draft EBA standards are not captured in our numbers. These could have

additional, potentially significant effects on our capital position and RWAs.

The detailed basis of preparation can be found under Appendix to Capital on page 324 of the *Annual Report and Accounts 2013*.

Table 8: Composition of regulatory capital on an estimated CRD IV end point basis and Year 1 transitional basis

	At 31 December 2013 US$m
Shareholders equity	**164,057**
Shareholders equity per balance sheet[1]	**181,871**
Foreseeable interim dividend	**(3,005)**
Preference share premium	**(1,405)**
Other equity instruments	**(5,851)**
Deconsolidation of special purpose entities[2]	**(1,166)**
Deconsolidation of insurance entities	**(6,387)**
Non-controlling interests	**3,644**
Non-controlling interests per balance sheet	