HSBC Holdings plc

6-K specific disclosures
30 June 2018

HSBC

Ratios of earnings to combined fixed charges (and preference share dividends)

	Half-year ended 30 Jun	Year ended 31 Dec				
	2018	2017	2016	2015	2014	2013
Ratios of earnings to fixed charges:						
– excluding interest on deposits	**2.54**	2.76	1.79	3.68	3.39	3.84
– including interest on deposits	**1.91**	2.00	1.37	2.00	1.86	2.09
Ratios of earnings to fixed charges and preference share dividends:						
– excluding interest on deposits	**2.22**	2.26	1.31	3.05	3.07	3.50
– including interest on deposits	**1.76**	1.77	1.17	1.85	1.79	2.01

Computation of ratios of earnings to combined fixed charges (and preference share dividends)

For the purpose of calculating the ratios, earnings consist of income from continuing operations before taxation and non-controlling interests, plus fixed charges, and after deduction of the unremitted pre-tax income of associated undertakings. Fixed charges consist of total interest expense, including or excluding interest on deposits, as appropriate, dividends on preference shares and other equity instruments, as applicable, and the proportion of rental expense deemed representative of the interest factor.

		Half-year ended 30 Jun	Year ended 31 Dec				
		2018	2017	2016	2015	2014	2013
	Footnotes	**$m**	$m	$m	$m	$m	$m
Profit before tax		**10,712**	17,167	7,112	18,867	18,680	22,565
– dividends received from associates		**126**	740	751	879	757	694
– share of profit in associates and joint ventures		**(1,381)**	(2,375)	(2,354)	(2,556)	(2,532)	(2,325)
Fixed charges		**10,359**	15,594	15,063	17,250	19,667	19,238
– interest on deposits		**4,200**	6,790	8,127	10,846	12,581	11,874
– rental expense and other charges	*1*	**6,159**	8,804	6,936	6,404	7,086	7,364
Earnings	*2*						
– excluding interest on deposits		**15,616**	24,336	12,445	23,594	23,991	28,298
– including interest on deposits		**19,816**	31,126	20,572	34,440	36,572	40,172
Preference share dividends	*3*	**892**	1,964	2,563	1,334	728	726
Combined fixed charges and preference share							
– excluding interest on deposits		**7,050**	10,768	9,499	7,738	7,814	8,090
– including interest on deposits		**11,250**	17,558	17,626	18,584	20,395	19,964

1 *Includes an estimate of the interest in rental expense, charges incurred in respect of subordinated liabilities and interest on preference shares.*
2 *Includes profit before tax, dividends received from associates and fixed charges, less share of profit in associates and joint ventures.*
3 *Dividends on preference shares and other equity instruments.*

Risk elements in the loan portfolio

Unless otherwise stated, the disclosure of credit risk elements in this section reflects US accounting practice and classifications. The purpose of the disclosure is to present within the US disclosure framework those elements of the loan portfolios with a greater risk of loss. The three main classifications of credit risk elements presented are:

- impaired loans;
- unimpaired loans contractually more than 90 days past due as to interest or principal; and
- troubled debt restructurings not included in the above.

Impaired loans

In the following tables, we present information on our impaired loans and advances in accordance with the classification approach described in the Annual Report and Accounts 2017 for balances at 31 December 2017. Balances at 30 June 2018 are presented in accordance with the information about the application of IFRS 9 'Financial Instruments' set out in the 2018 Interim report.

A loan is impaired, and an impairment allowance is recognised, when there is objective evidence of a loss event that has an effect on the cash flows of the loan which can be reliably estimated. In accordance with IFRSs, we recognise interest income on assets after they have been written down as a result of an impairment loss.

Unimpaired loans more than 90 days past due

Under IFRS 9 the Group determines that a financial instrument is credit-impaired and in stage 3 by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
- the loan is otherwise considered to be in default.

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due, even where regulatory rules permit default to be defined based on 180 days past due. Therefore the definitions of credit-impaired and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit-impaired. Interest income is recognised by applying the effective interest rate to the amortised cost amount, (i.e. gross carrying amount less ECL allowance).

As a financial instrument is considered impaired if contractual payments of either principal or interest are past due for more than 90 days these amounts will be reported under impaired loans with no balance reported under unimpaired loans more than 90 days past due.

Prior to IFRS 9, examples of unimpaired loans more than 90 days past due included individually assessed mortgages that are in arrears more than 90 days where there was no other indicators of impairment, but where the value of collateral was sufficient to repay both the principal debt and all potential interest for at least one year; and short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there was no concern over the creditworthiness of the counterparty.

Troubled debt restructurings

Under US GAAP, a troubled debt restructuring ('TDR') is a loan, the terms of which have been modified for economic or legal reasons related to the borrower's financial difficulties to grant a concession to the borrower that the lender would not otherwise consider. A modification which results in a delay in payment that is considered insignificant is not regarded as a concession for the purposes of this disclosure. The SEC requires separate disclosure of any loans which meet the definition of a TDR that are not included in the previous two loan categories. Loans that have been identified as TDRs under the US guidance retain this designation until maturity or derecognition. This treatment differs from the Group's impaired loans disclosure convention under IFRSs
under which a loan may return to unimpaired status after demonstrating a significant reduction in the risk of non-payment of future cash flows. As a result, reported TDRs include those loans that have returned to unimpaired status under the Group's disclosure convention for renegotiated loans.

The balance of TDRs not included as impaired loans at 30 June 2018 was $2.2bn, $0.7bn lower than at 31 December 2017. Under the Group's IFRS 9 methodology financial instruments (except for renegotiated loans) are transferred out of stage 3 when they no longer exhibit any evidence of credit impairment. Wholesale Renegotiated loans will continue to be in stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, observed over a minimum one-year period and there are no other indicators of impairment. For loans that are assessed for impairment on a portfolio basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis. Retail renegotiated loans are deemed to remain credit impaired until repayment or derecognition.

Potential problem loans

Potential problem loans are loans where information on possible credit problems among borrowers causes management to seriously doubt their ability to comply with the loan repayment terms.

Under IFRS 9, an assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. Any financial instrument which has deemed to have suffered a significant increase in credit risk is transferred from stage 1 to stage 2.

The assessment explicitly or implicitly compares the risk of default occurring at the reporting date compared to that at initial recognition, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL.

The analysis of credit risk is multifactor. The determination of whether a specific factor is relevant and its weight compared with other factors depends on the type of product, the characteristics of the financial instrument and the borrower, and the geographical region. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk and these criteria will differ for different types of lending, particularly between retail and wholesale. However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due.Financial instruments classified as stage 2 and greater than 30 days past due are considered to have a higher risk of containing potential problem loans.

Analysis of risk elements in the loan portfolio by geographical region

The analysis below sets out the amount of risk elements in loan portfolios included within loans and advances to customers and banks in the consolidated balance sheet, trading loans classified as in default and assets obtained by taking possession of security.

The table excludes the amount of risk elements in loan portfolios classified as 'Assets held for sale' in the consolidated balance sheet.

Risk elements in the loan portfolio by geographical region

	At	
	At 30 Jun 2018	At 31 Dec 2017
	$m	$m
Impaired loans	**14,548**	15,470
– Europe	**7,306**	8,042
– Asia	**2,530**	2,249
– Middle East and North Africa	**2,232**	1,949
– North America	**1,867**	2,606
– Latin America	**613**	624
Unimpaired loans contractually more than 90 days past due as to principal or interest	**—**	24
– Europe	**—**	—
– Asia	**—**	—
– Middle East and North Africa	**—**	24
– North America	**—**	—
– Latin America	**—**	—
Troubled debt restructurings (not included in the classifications above)	**2,187**	2,879
– Europe	**1,392**	1,890
– Asia	**86**	273
– Middle East and North Africa	**474**	459
– North America	**194**	174
– Latin America	**41**	83
Trading loans classified as in default	**—**	56
– Europe	**—**	56
– Asia	**—**	—
– Middle East and North Africa	**—**	—
– North America	**—**	—
– Latin America	**—**	—
Risk elements on loans	**16,735**	18,429
– Europe	**8,698**	9,988
– Asia	**2,616**	2,522
– Middle East and North Africa	**2,706**	2,432
– North America	**2,061**	2,780
– Latin America	**654**	707
Assets held for resale	**87**	94
– Europe	**11**	14
– Asia	**59**	51
– Middle East and North Africa	**—**	—
– North America	**12**	11
– Latin America	**5**	18
Total risk elements	**16,822**	18,523
– Europe	**8,709**	10,002
– Asia	**2,675**	2,573
– Middle East and North Africa	**2,706**	2,432
– North America	**2,073**	2,791
– Latin America	**659**	725
	%	%
Loan impairment allowances as a percentage of risk elements on loans	**52.3**	40.6

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