HSBC Bank plc

Pillar 3 Disclosures at 31 December 2018

HSBC

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Certain defined terms

Unless the context requires otherwise, 'HSBC Holdings' means HSBC Holdings plc, and 'HSBC' and the 'Group' refer to HSBC Holdings together with its subsidiaries; similarly, 'HSBC Bank' and the 'bank' mean HSBC Bank plc, and the 'group' refers to HSBC Bank together with its subsidiaries. When used in the terms 'shareholders' equity' and 'total shareholders' equity', 'shareholders' means holders of HSBC Bank ordinary shares and those preference shares and capital securities issued by HSBC Bank classified as equity. The abbreviations '£m' and '£bn' represent millions and billions (thousands of millions) of GB pounds respectively.

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HSBC Bank plc has adopted the EU's regulatory transitional arrangements for International Financial Reporting Standard ('IFRS') 9 Financial instruments.
A number of tables in this document report under this arrangement as follows:
a. Some figures for 2018 (as indicated ^) within this table have been prepared on an IFRS 9 transitional basis
b. All figures within this table has been prepared on an IFRS 9 transitional basis
All other tables report numbers on the basis of full adoption of IFRS 9.

Introduction

Table 1: Comparison of own funds, capital and leverage ratios, with and without the application of transitional arrangements for IFRS 9 (IFRS9-FL)

			At			
			31 Dec	30 Jun	1 Jan	31 Dec[1]
		Footnotes	**2018**	2018	2018	2017
	Available capital (£bn)	*2*				
1	Common equity tier 1 ('CET1') capital	^	**19.8**	30.6	27.6	27.4
2	CET1 capital as if IFRS 9 transitional arrangements had not been applied		**19.8**	30.5	27.5	N/A
3	Tier 1 capital	^	**23.1**	36.0	32.4	32.2
4	Tier 1 capital as if IFRS 9 transitional arrangements had not been applied		**23.0**	35.9	32.3	N/A
5	Total regulatory capital	^	**37.7**	43.7	39.4	39.3
6	Total capital as if IFRS 9 transitional arrangements had not been applied		**37.6**	43.6	39.3	N/A
	Risk-weighted assets ('RWAs') (£bn)					
7	Total RWAs		**143.9**	230.4	233.4	233.1
8	Total RWAs as if IFRS 9 transitional arrangements had not been applied		**143.8**	230.3	233.4	N/A
	Capital ratios (%)	*2*				
9	CET1	^	**13.8**	13.3	11.8	11.8
10	CET1 as if IFRS 9 transitional arrangements had not been applied		**13.7**	13.2	11.8	N/A
11	Total tier 1	^	**16.0**	15.6	13.9	13.8
12	Tier 1 as if IFRS 9 transitional arrangements had not been applied		**16.0**	15.6	13.8	N/A
13	Total capital	^	**26.2**	19.0	16.9	16.9
14	Total capital as if IFRS 9 transitional arrangements had not been applied		**26.1**	18.9	16.9	N/A
	Leverage ratio	*3*				
15	Total leverage ratio exposure (£bn)	^	**570.0**	841.4	787.2	787.2
16	Leverage ratio (%)	^	**3.9**	4.2	4.0	4.0
17	Leverage ratio as if IFRS 9 transitional arrangements had not been applied (%)		**3.9**	4.2	4.0	N/A

1 *Figures presented as reported under IAS 39 at 31 December 2017.*
2 *Capital figures and ratios are reported on the CRD IV transitional basis for additional tier 1 and tier 2 capital in accordance with articles 484-92 of the Capital Requirements Regulation.*
3 *Leverage ratio is calculated using the CRD IV end-point basis for additional tier 1 capital.*

For regulatory reporting, the group has adopted the transitional arrangements (including paragraph 4 of CRR article 473a) published by the EU on 27 December 2017 for IFRS 9 'Financial Instruments'. These permit banks to add back to their capital base a proportion of the impact that IFRS 9 has upon their loan loss allowances during the first five years of use. The proportion that banks may add back starts at 95% in 2018, and reduces to 25% by 2022.

Further details of the implications of IFRS 9 for financial and regulatory reporting are disclosed on page 5 of the HSBC Holdings plc Pillar 3 Disclosure 31 December 2018 *and on page 34 of the HSBC Holdings plc* Annual Report and Accounts 2018*.*

Table 2: Reconciliation of capital with and without IFRS 9 transitional arrangements applied

	At 31 Dec 2018		
	CET1	**Tier 1**	**Total own funds**
	£m	**£m**	**£m**
Reported balance using IFRS 9 transitional arrangements	**19,831**	**23,079**	**37,671**
Expected credit losses ('ECL') reversed under transitional arrangements for IFRS 9	**(104)**	**(104)**	**(104)**
– Standardised approach	**(104)**	**(104)**	**(104)**
– Internal ratings based ('IRB') approach	**—**	**—**	**—**
Tax impacts	**26**	**26**	**26**
Changes in amounts deducted from CET1 for deferred tax assets and significant investments	**(1)**	**(1)**	**(1)**
– amounts deducted from CET1 for deferred tax assets	**(1)**	**(1)**	**(1)**
– amounts deducted from CET1 for significant investments	**—**	**—**	**—**
Reported balance excluding IFRS 9 transitional arrangements	**19,752**	**23,000**	**37,592**

Table 3: Pillar 1 overview

		RWAs		Capital required[1]	
		2018	2017	**2018**	2017
	Footnotes	**£m**	£m	**£m**	£m
Credit risk	*2*	**88,822**	164,767	**7,105**	13,182
Counterparty credit risk		**24,669**	24,018	**1,974**	1,921
Market risk		**17,534**	20,978	**1,403**	1,678
Operational risk		**12,850**	23,310	**1,028**	1,865
At 31 Dec		**143,875**	233,073	**11,510**	18,646

Table 4: RWAs by global business[3]

	RWAs		Capital required[1]	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Retail Banking and Wealth Management ('RBWM')	**7,032**	26,676	**563**	2,134
Commercial Banking ('CMB')	**31,910**	85,448	**2,553**	6,836
Global Banking and Markets ('GB&M')	**91,408**	97,397	**7,312**	7,792
Global Private Banking ('GPB')	**2,012**	3,540	**161**	283
Corporate Centre	**11,513**	20,012	**921**	1,601
At 31 Dec	**143,875**	233,073	**11,510**	18,646

1 *'Capital required', here and in all tables where the term is used, represents the minimum total capital charge set at 8% of RWAs by article 92 of the Capital Requirements Regulation.*
2 *'Credit Risk', here and in all tables where the term is used, excludes counterparty credit risk.*
3 *Please refer to pages 5 of the HSBC Bank plc* Annual Report and Accounts 2018 *for a description of the activities of our global businesses.*

Regulatory framework for disclosures

HSBC is supervised on a consolidated basis in the UK by the Prudential Regulation Authority ('PRA'), which 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, including the PRA itself in certain circumstances (for example, the bank), who set and monitor 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 the HSBC Bank level, we calculated capital for prudential regulatory reporting purposes throughout 2018 using the Basel III framework of the Basel Committee on Banking Supervision ('BCBS') as implemented by the EU in the amended Capital Requirements Directive and Regulation, collectively known as CRD IV, and in the PRA's rulebook for the UK banking industry. The regulators of group banking entities outside the EU are at varying stages of implementation of the BCBS' framework, so local regulation in 2018 may have been on the basis of a previous framework.

The Basel Committee's framework is structured around three 'pillars': 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 that allow market participants to assess the scope of application by banks of the Basel Committee's framework and the rules in their jurisdiction, their capital condition, risk exposures and risk management 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 PRA's final rules adopted national discretions in order to accelerate significantly the transition timetable to full 'end point' CRD IV compliance.

Pillar 3 disclosures

The HSBC Bank *Pillar 3 Disclosures 2018* comprise information required under Pillar 3, both quantitative and qualitative. They are made in accordance with Part 8 of the Capital Requirements Regulation within CRD IV, supplemented by any specific additional requirements of the PRA and discretionary disclosures on our part.

In our disclosures, to give insight into movements during the year, we provide comparative figures for the previous year. Key ratios and figures are reflected throughout the HSBC Bank plc *Pillar 3 Disclosures 2018* and are also available on page 69 of the HSBC Bank plc *Annual Report and Accounts 2018*. Where disclosures have been enhanced or are new, we do not generally restate or provide prior year comparatives. In these HSBC Bank *Pillar 3 Disclosures 2018* we have adopted a number of tables from the EBA Pillar 3 guidelines to replace previously reported tables. We do not provide prior year comparatives for these tables in line with our stated approach and the EBA guidelines on adoption.

The own funds disclosure in Table 6 tracks the position from a CRD IV transitional to an end-point basis.

We publish comprehensive Pillar 3 disclosures annually on the HSBC website, www.hsbc.com, simultaneously with the release of our HSBC Bank plc *Annual Report and Accounts*. Our Interim Reports include regulatory information complementing the financial and risk information presented there and in line with the new requirements on the frequency of regulatory disclosures.

Pillar 3 requirements may be met by inclusion in other disclosure media. Where we adopt this approach, references are provided to the relevant pages of the *Annual Report and Accounts 2018* or other locations.

We continue to engage in the work of the UK authorities and industry associations to improve the transparency and comparability of UK banks' Pillar 3 disclosures.

Ring-fenced bank

The UK Financial Services (Banking Reform) Act 2013 and associated secondary legislation and regulatory rules require UK deposit-taking banks with more than £25bn of 'core deposits' (broadly from individuals and small to medium-sized businesses) to separate their UK retail banking activities from their other wholesale and investment banking activities by 1 January 2019. The resulting UK ring-fenced bank ('RFB') entities need to be legally distinct, operationally separate and economically independent from the non-ring-fenced bank entities.

HSBC completed the ring-fencing of its UK retail banking activities on 1 July 2018, six months in advance of the legal requirement coming into force, transferring circa 14.5 million qualifying RBWM, CMB and GPB customers from HSBC Bank plc to HSBC UK Bank plc ('HSBC UK'), HSBC's ring-fenced bank. This included the transfer of relevant retail banking subsidiaries.

HSBC Bank plc, which is HSBC's non-ring-fenced bank, has retained the non-qualifying components, primarily the UK GB&M business and the overseas branches and subsidiaries. The two banking entities will operate alongside each other, supported by services received from HSBC Global Services (UK) Limited.

Comparatives for the group at 31 December 2017 throughout this document have not been restated to account for the impact of the demerger.

Further information regarding the impacts of the ring-fencing demerger is provided in the following sections of the HSBC Bank plc Annual Report and Accounts 2018 *as follows:*

- *in Structural reform under the heading Ring-fenced bank on page 18;*
- *in Note 1: Basis of preparation and significant accounting policies on page 97; and*
- *in Note 35: Discontinued operations on page 161.*

Regulatory developments

The UK's withdrawal from the EU

In August 2018, Her Majesty's Treasury ('HMT') commenced the process of 'onshoring' the current European Union ('EU') legislation to ensure that there is legal continuity in the event of the UK leaving the EU. This involved the publication of draft Statutory Instruments across a wide range of financial services legislation; this included the key prudential legislation for banking groups: the Capital Requirements Directive ('CRD') and the Capital Requirements Regulation ('CRR').

One of the key effects of onshoring will be to treat the EU in the same manner as the EU currently treats non-European Economic Area countries. Under the draft provisions published by HMT, the PRA will be given the power to grant transitional provisions to delay the implementation of these changes for up to two years, should the UK leave the EU without an agreement on 29 March 2019.

The Bank of England ('BoE') and the PRA published a package of consultations in October and December 2018, setting out the changes required to the PRA's rules and technical standards as a result of the UK's withdrawal. It also included proposals on the exercise of the transitional powers; however the precise scope of these remains uncertain.

There are certain pieces of EU legislation that are in progress, but are not yet live, that will not enter automatically into UK law if it withdraws from the EU without an agreement. The Financial Services (Implementation of Legislation) Bill is currently progressing through the UK Parliament to empower HMT to make regulations in the UK to bring into force certain specified EU legislation that remains in progress on 29 March 2019.

RWAs and leverage ratio

Basel Committee

In December 2017, the Basel Committee ('Basel') published revisions to the Basel III framework. The final package includes:

- widespread changes to the risk weights under the standardised approach to credit risk;
- a change in the scope of application of the internal ratings based ('IRB') approach to credit risk, together with changes to the IRB methodology;
- the replacement of the operational risk approaches with a single methodology;
- an amended set of rules for the credit valuation adjustment ('CVA') capital framework;
- an aggregate output capital floor that ensures that banks' total RWAs are no lower than 72.5% of those generated by the standardised approaches; and
- changes to the exposure measure for the leverage ratio.

Further refinements to the leverage ratio exposure measure for centrally cleared derivatives and disclosure of daily-average exposure measures are also under consideration.

Following a recalibration, Basel published in January 2019 the final changes to the market risk RWA regime, the Fundamental Review of the Trading book ('FRTB'). The new regime contains a more clearly defined trading book boundary, the introduction of an internal models approach based upon expected shortfall models, capital requirements for non-modellable risk factors and a more risk-sensitive standardised approach that can serve as a fall-back for the internal models method.

Basel has announced that the package will be implemented on 1 January 2022, with a five-year transitional provision for the output floor, commencing at a rate of 50%. The final standards will need to be transposed into the relevant local law before coming into effect.HSBC continues to evaluate the final package. Given that the package contains a significant number of national discretions, the possible outcome is uncertain.

European Union

In the EU, Basel's reforms are being implemented through revisions to the CRR and CRD. It is understood that the first tranche of Basel's reforms, collectively referred to as CRR2, has been agreed and will follow a phased implementation commencing in 2019; however, it has yet to enter into law. It includes the changes to market risk under the FRTB, revisions to the counterparty credit risk framework and the new leverage ratio rules.

The CRR2 is included within the scope of the Financial Services (Implementation of Legislation) Bill. If passed by the UK Parliament, this would empower HMT to bring CRR2 into UK law even if it is not in force in the EU on exit day.

In May 2018, the European Commission commenced the process of implementing the second tranche of Basel's reforms, collectively known as CRR3, by requesting that the EBA report on the adoption of the remaining reforms on the EU's banking sector and the wider economy. This tranche will include Basel's reforms in relation to credit risk, operational risk and CVA, together with the output floor. The EBA's final report on the details of the EU's adoption of the reforms is not due to be published until the end of June.

Separately, in January 2019, the EU published final proposals for a prudential backstop for non-performing loans, which will result in a deduction from Common Equity Tier 1 ('CET1') capital when a minimum impairment coverage requirement is not met. The regime is expected to be implemented in the first half of 2019.

Furthermore, the EU continues to work on its 'IRB Repair' programme, issuing in November 2018 near final guidance on the specification of economic downturn for the purposes of the loss given default modelling and the final rules on the specification of the definition of default.

Finally, in January 2019, the new securitisation framework came into force in the EU for new transactions. Existing transactions will be subject to the framework on 1 January 2020. This regime introduces changes to the methodology for determining RWAs for securitisation positions, with beneficial treatments for simple, transparent and standardised securitisation transactions.

Bank of England

In October 2018, the PRA published a consultation on its supervisory expectations and approach to the financial risks from climate change. This focused on its expectations of firms on the incorporation of the risk from climate change into risk management practices and stress testing, as well as firms' climate change disclosures and internal governance. The PRA has indicated that it expects that the material financial risks from climate change should be included within Pillar 2.

Capital resources, macroprudential, recovery & resolution and total loss absorbing capacity

European Union

In addition to the changes to RWAs, CRR2 will implement changes in the own funds calculation and eligibility criteria. Similar applicability issues will arise in relation to the UK's withdrawal from the EU.

Bank of England

In June 2018, the BoE published its approach to setting Minimum requirements for own funds and eligible liabilities ('MREL') within groups, known as internal MREL, and its final policy on selected outstanding MREL policy matters. These requirements came into effect on 1 January 2019. The PRA also published its expectations for MREL reporting, which are also now in force.

The BoE is expected to publish policy proposals for the treatment of a firm's holdings of other institutions' MREL, pending their assessment of the development of the EU's requirements in this area. The BoE is also expected to review the calibration of MREL and the final compliance date by the end of 2020.

In December 2018, the BoE published a consultation on its approach to assessing resolvability. This outlines how it assesses resolvability through its established policies and further proposes new principles on funding and operational continuity in resolution and firms' restructuring capabilities, as well as management, governance and communication capabilities. Simultaneously, the PRA published a consultation on resolution assessments and public disclosure by firms. Together, these publications contain proposals to form a Resolvability Assessment Framework, presented as the final element in the UK's resolution regime.

In addition, a number of other changes have come into effect:

- In June 2018, the PRA published modifications to its intra-group large exposures framework, which came into force with immediate effect.
- In November 2018, the UK's Countercyclical Capital Buffer rate increased from 0.5% to 1%.

Linkage to the *Annual Report and Accounts 2018*

Structure of the regulatory group

Subsidiaries engaged in insurance activities are excluded from the regulatory consolidation by excluding assets, liabilities and post-acquisition reserves. The group's investments in these insurance subsidiaries are recorded at cost and deducted from common equity tier 1 ('CET1') capital (subject to thresholds).

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.

Participating interests in banking associates are proportionally consolidated for regulatory purposes by including our share of assets, liabilities, profit and loss, and risk-weighted assets ('RWAs') in accordance with the PRA's application of EU legislation. Non-participating significant investments, along with non-financial associates, are deducted from capital (subject to thresholds).

Table 5: Reconciliation of balance sheets – financial accounting to regulatory scope of consolidation

	Ref †	Accounting balance sheet £m	Deconsolidation of insurance/ other entities £m	Consolidation of banking associates £m	Regulatory balance sheet £m
Assets					
Cash and balances at central banks		**52,013**	**–**	**22**	**52,035**
Items in the course of collection from other banks		**839**	**–**	**–**	**839**
Trading assets		**95,420**	**43**	**–**	**95,463**
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss		**17,799**	**(10,112)**	**341**	**8,028**
– *of which:* *debt securities eligible as Tier 2 issued by Group FSEs that are outside the regulatory scope of consolidation*	*r*	***332***	***(332)***	**–**	**–**
Derivatives		**144,522**	**(45)**	**–**	**144,477**
Loans and advances to banks		**13,628**	**(189)**	**–**	**13,439**
– *of which: lending to FSE eligible as Tier 2*	*r*	***40***	**–**	**–**	***40***
Loans and advances to customers		**111,964**	**(1,375)**	**–**	**110,589**
– *of which: expected credit losses on IRB portfolios*	*h*	***(958)***	**–**	**–**	***(958)***
Reverse repurchase agreements – non-trading		**80,102**	**–**	**–**	**80,102**
Financial investments		**47,272**	**(10,103)**	**–**	**37,169**
Capital invested in insurance and other entities		**–**	**626**	**–**	**626**
Prepayments, accrued income and other assets		**37,497**	**(1,001)**	**27**	**36,523**
– *of which: retirement benefit assets*	*j*	***25***	**–**	**–**	***25***
Current tax assets		**337**	**(10)**	**–**	**327**
Interests in associates and joint ventures		**399**	**–**	**(385)**	**14**
Goodwill and intangible assets	*e*	**2,626**	**(652)**	**–**	**1,974**
Deferred tax assets	*f*	**540**	**134**	**–**	**674**
Total assets at 31 Dec 2018		**604,958**	**(22,684)**	**5**	**582,279**
Liabilities and equity					
Liabilities					
Deposits by banks		**24,532**	**–**	**–**	**24,532**
Customer accounts		**180,836**	**683**	**–**	**181,519**
Repurchase agreements – non-trading		**46,583**	**–**	**–**	**46,583**
Items in the course of transmission to other banks		**351**	**–**	**–**	**351**
Trading liabilities		**49,514**	**–**	**–**	**49,514**
Financial liabilities designated at fair value		**36,922**	**143**	**–**	**37,065**
– *of which:*					
included in tier 1	*l*	***322***	**–**	**–**	***322***
included in tier 2	*n, q, i*	***994***	**–**	**–**	***994***
Derivatives		**139,932**	**45**	**–**	**139,977**
– *of which: debit valuation adjustment*	*i*	***50***	**–**	**–**	***50***
Debt securities in issue		**22,721**	**(1,410)**	**–**	**21,311**
Accruals, deferred income and other liabilities		**41,036**	**(782)**	**4**	**40,258**
Current tax liabilities		**128**	**(3)**	**–**	**125**
Liabilities under insurance contracts		**20,657**	**(20,657)**	**–**	**–**
Provisions		**538**	**(2)**	**–**	**536**
– *of which:* *credit-related contingent liabilities and contractual commitments on IRB portfolios*	*h*	***99***	**–**	**–**	***99***
Deferred tax liabilities		**29**	**(29)**	**1**	**1**
Subordinated liabilities		**13,770**	**–**	**–**	**13,770**
– *of which:*					
included in tier 1	*l*	***700***	**–**	**–**	***700***
included in tier 2	*n, q*	***12,532***	**–**	**–**	***12,532***
Total liabilities at 31 Dec 2018		**577,549**	**(22,012)**	**5**	**555,542**
Equity					
Called up share capital	*a*	**797**	**–**	**–**	**797**
Other equity instruments	*k*	**2,403**	**–**	**–**	**2,403**
Other reserves	*c, g*	**(4,971)**	**9**	**–**	**(4,962)**
Retained earnings	*b, c*	**28,649**	**(681)**	**–**	**27,968**
Total shareholders' equity		**26,878**	**(672)**	**–**	**26,206**
Non-controlling interests	*d, m, q*	**531**	**–**	**–**	**531**
Total equity at 31 Dec 2018		**27,409**	**(672)**	**–**	**26,737**
Total liabilities and equity at 31 Dec 2018		**604,958**	**(22,684)**	**5**	**582,279**

Table 5: Reconciliation of balance sheets – financial accounting to regulatory scope of consolidation (continued)

	Ref †	Accounting balance sheet	Deconsolidation of insurance/ other entities	Consolidation of banking associates	Regulatory balance sheet
		£m	£m	£m	£m
Assets					
Cash and balances at central banks		97,601	—	109	97,710
Items in the course of collection from other banks		2,023	—	—	2,023
Trading assets		145,725	94	127	145,946
Financial assets designated at fair value		9,266	(9,219)	—	47
– *of which:* *debt securities eligible as Tier 2 issued by Group FSEs that are outside the regulatory scope of consolidation*	*r*	*240*	*(240)*	—	—
Derivatives		143,335	(54)	—	143,281
Loans and advances to banks		14,149	(124)	1	14,026
– *of which: lending to FSE eligible as Tier 2*	*r*	*55*	—	—	*55*
Loans and advances to customers		280,402	(2,564)	—	277,838
impairment allowances on IRB portfolios	*h*	*(1,871)*	—	—	*(1,871)*
Reverse repurchase agreements – non-trading		45,808	—	—	45,808
Financial investments		58,000	(11,771)	157	46,386
Capital invested in insurance and other entities		—	630	—	630
Prepayments, accrued income and other assets		16,026	(1,446)	23	14,603
– *of which: retirement benefit assets*	*j*	*6,066*	—	—	*6,066*
Current tax assets		140	(3)	—	137
Interests in associates and joint ventures		327	(3)	(313)	11
Goodwill and intangible assets	*e*	5,936	(591)	—	5,345
Deferred tax assets	*f*	130	129	—	259
Total assets at 31 Dec 2017		818,868	(24,922)	104	794,050
Liabilities and equity					
Liabilities					
Deposits by banks		29,349	(48)	92	29,393
Customer accounts		381,546	535	—	382,081
Repurchase agreements – non-trading		37,775	—	—	37,775
Items in the course of transmission to other banks		1,089	—	—	1,089
Trading liabilities		106,496	635	—	107,131
Financial liabilities designated at fair value		18,249	(537)	—	17,712
– *of which:*					
included in tier 1	*l*	*339*	—	—	*339*
included in tier 2	*n, q, i*	*1,751*	—	—	*1,751*
Derivatives		140,070	34	—	140,104
– *of which: debit valuation adjustment*	*j*	*18*	—	—	*18*
Debt securities in issue		13,286	(2,480)	—	10,806
Accruals, deferred income and other liabilities		6,615	(1,288)	12	5,339
Current tax liabilities		88	(38)	—	50
Liabilities under insurance contracts		21,033	(21,033)	—	—
Provisions		1,796	(6)	—	1,790
– *of which:* *credit-related contingent liabilities and contractual commitments on IRB portfolios*	*h*	*53*	—	—	*53*
Deferred tax liabilities		933	—	—	933
Subordinated liabilities		16,494	—	—	16,494
– *of which:*					
included in tier 1	*l*	*700*	—	—	*700*
included in tier 2	*n, q*	*5,690*	—	—	*5,690*
Total liabilities at 31 Dec 2017		774,819	(24,226)	104	750,697
Equity					
Called up share capital	*a*	797	—	—	797
Other equity instruments	*k*	3,781	—	—	3,781
Other reserves	*c, g*	2,744	—	—	2,744
Retained earnings	*b, c*	36,140	(696)	—	35,444
Total shareholders' equity		43,462	(696)	—	42,766
Non-controlling interests	*d, m, q*	587	—	—	587
Total equity at 31 Dec 2017		44,049	(696)	—	43,353
Total liabilities and equity at 31 Dec 2017		818,868	(24,922)	104	794,050

† *The references (a) – (r) identify balance sheet components which are used in the calculation of regulatory capital on page 10.*

Capital and Leverage

Capital management

Approach and policy

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.

It is our objective to maintain a strong capital base to support the development of our business and to exceed regulatory capital requirements at all times. To achieve this, we manage our capital within the context of an annual capital plan that is approved by the Board and determines the optimal amount and mix of capital required to support planned business growth and meet local regulatory capital requirements.

Our policy on capital management is underpinned by the capital management framework and our internal capital adequacy assessment process, which enable the group to manage its capital in a consistent manner. The framework incorporates a number of different capital measures that govern the management and allocation of capital within the group. These capital measures are defined by the group as follows:

- invested capital is the equity capital provided to the bank by HSBC through the intermediary company HSBC UK Holdings Limited;
- economic capital is the internally calculated capital requirement that is deemed necessary by the group to support the risks to which it is exposed; and
- regulatory capital is the minimum level of capital that the group is required to hold in accordance with the rules established by the PRA for the bank and the group, and by the local regulators for individual subsidiary companies.

The following risks managed through the capital management framework have been identified as material: credit, market, operational, interest rate risk in the banking book, pensions, insurance and residual risks.

Stress testing

Stress testing is incorporated into the capital management framework, and is an important component of understanding the sensitivity of the core assumptions in the group's capital plans to the adverse effect of extreme, but plausible, events. Stress testing allows senior management to formulate its response, including risk mitigating actions, in advance of conditions starting to reflect the stress scenarios identified. The actual market stresses experienced by the financial system in recent years have been used to inform the capital planning process and further develop the scenarios employed by the group in its internal stress tests.

Other stress tests are also carried out, both at the request of regulators and by the regulators themselves, using their prescribed assumptions. The group takes into account the results of all such regulatory stress testing when assessing its internal capital requirements.

Risks to capital

Outside the stress testing framework, a list of principal risks is regularly evaluated for their effect on our capital ratios. In addition, other risks may be identified that have the potential to affect our RWAs and/or capital position. The downside or upside scenarios are assessed against our capital management objectives and mitigating actions are assigned as necessary.

The group's approach to managing its capital position has been to ensure the bank, its regulated subsidiaries and the group exceed current regulatory requirements, and it is well placed to meet expected future capital requirements.

Risk-weighted asset targets

RWA targets for our global businesses are established in accordance with the Group's strategic direction and risk appetite, and approved through the Group's annual planning process. As these targets are deployed to lower levels of management, action plans for implementation are developed. These may include growth strategies, active portfolio management, restructuring, business and/or customer-level reviews, RWA accuracy and allocation initiatives, and risk mitigation.

Business performance against RWA targets is monitored through regular reporting to the Asset, Liability and Capital Management Committee.

Capital generation

HSBC Holdings plc, through its intermediary company HSBC UK Holdings Limited, is the sole provider of equity capital to the group and also provides non-equity capital where necessary. Capital generated in excess of planned requirements is ultimately returned to HSBC Holdings plc in the form of dividends.

Overview of regulatory capital framework

Main features of CET1, AT1 and T2 instruments issued by the group

All capital securities included in the regulatory capital base of the group have been issued either in accordance with the rules and guidance in the PRA's General Prudential Sourcebook and have been included in the capital base by virtue of the application of the CRD IV grandfathering provisions, or issued as fully compliant CRD IV securities. For regulatory purposes, the group's capital base is divided into three main categories, namely Common Equity Tier 1, Additional Tier 1 and Tier 2, depending on the degree of permanence and loss absorbency exhibited. The main features of capital securities issued by the group are described below.

Non-CRD IV compliant Additional Tier 1 and Tier 2 instruments benefit from a grandfathering period. This progressively reduces the eligible amount by 10% annually, following an initial reduction of 20% on 1 January 2014, until they are fully phased out by 1 January 2022.

Tier 1 capital ('T1')

Tier 1 capital comprises shareholders' equity, related non-controlling interests (subject to limits) and qualifying capital instruments, after certain regulatory adjustments.

Common Equity Tier 1 ('CET1')

Called up ordinary shares issued by the bank to its parent are fully paid up and the proceeds of issuance are immediately and fully available. There is no obligation to pay a coupon or dividend to the shareholder arising from this type of capital. The share capital is available for unrestricted and immediate use to cover any risks and losses.

Additional Tier 1 capital ('AT1')

Preference shares and related premium

Preference shares are securities that rank higher than ordinary shares for dividend payments, and in the event of a winding up, but generally carry no voting rights. These instruments have no stated maturity date but may be called and redeemed by the issuer, subject to prior consent from the PRA and, where applicable, the local banking regulator. There must also be no obligation to pay a dividend, and (if not paid) the dividend may not cumulate.

Further details of the HSBC Bank plc non-cumulative third dollar preference share capital can be found in Note 29 – Called up share capital and other equity instruments of the Notes on the Financial Statements on pages 148 to 149 of the HSBC Bank plc Annual Report and Accounts 2018.

Other Tier 1 capital securities

Other Tier 1 capital securities are deeply subordinated securities with some equity features that may be included as Tier 1 capital. Other Tier 1 capital securities are instruments for which there is no obligation to pay a coupon, and (if not paid) the coupon is not cumulative. Such securities do not generally carry voting rights and rank higher than ordinary shares for coupon payments and in the event of a winding up. The securities may be called and redeemed by the issuer, subject to prior consent from the PRA and, where applicable, the local banking regulator. If not redeemed, coupons payable may step up and become floating rate related to interbank offered rates.

Further details of these instruments can be found in Note 26 – Subordinated Liabilities of the Notes on the Financial Statements on pages 143 to 144 of the HSBC Bank plc Annual Report and Accounts 2018.

Qualifying CRD IV Additional Tier 1 instruments are perpetual securities on which there is no obligation to apply a coupon and, if not paid, the coupon is not cumulative. Such securities do not carry voting rights but rank higher than ordinary shares for coupon payments and in the event of a winding up. Fully compliant CRD IV Additional Tier 1 instruments issued by the bank include a provision whereby the instrument will be written down wholly in the event the group's Common Equity Tier 1 ratio falls below 7.00%.

These instruments are accounted for as equity. Further details of qualifying CRD IV Additional Tier 1 instruments can be found in Note 29 – Called up share capital and other equity instruments of the Notes on the Financial Statements on pages 148 to 149 of the HSBC Bank plc Annual Report and Accounts 2018.

Tier 2 capital ('T2')

Tier 2 capital comprises eligible capital securities and any related share premium and other qualifying Tier 2 capital securities subject to limits. Holdings of Tier 2 capital of financial sector entities are deducted.

Perpetual and term subordinated debt

Tier 2 capital securities are either perpetual or dated subordinated securities on which there is an obligation to pay coupons.

These instruments or subordinated loans comprise dated loan capital repayable at par on maturity with an original maturity of at least five years. Some subordinated loan capital may be called and redeemed by the issuer subject to prior consent from the PRA and, where applicable, the consent of the local banking regulator. If not redeemed, interest coupons payable may step up or become floating rate related to interbank offered rates. For regulatory purposes, it is a requirement that Tier 2 instruments are amortised on a straight-line basis in their final five years to maturity, thus reducing the amount of capital that is recognised for regulatory purposes.

Further details of these instruments can be found in Note 26 – Subordinated Liabilities of the Notes on the Financial Statements on pages 143 to 144 of the HSBC Bank plc Annual Report and Accounts 2018.

A list of the features of our capital instruments in accordance with Annex III of the Commission Implementing Regulation 1423/2013 is also being published on HSBC's website with reference to our balance sheet on 31 December 2018.

As at 31 December 2018, the bank holds sufficient amount of CRR-eligible regulatory total capital to meet the existing and proposed Minimum Requirement for Own Funds and Eligible Liabilities (MREL) requirements.

Table 6: Own funds disclosure

Ref*		Ref †	At 31 Dec 2018 £m	CRD IV prescribed residual amount £m	Final CRD IV text £m
	Common equity tier 1 ('CET1') capital: instruments and reserves				
1	Capital instruments and the related share premium accounts		797		797
	– ordinary shares	a	797		797
2	Retained earnings	b	30,668		30,668
3	Accumulated other comprehensive income (and other reserves)	c	2,953		2,953
5	Minority interests (amount allowed in consolidated CET1)	d	372		372
5a	Independently reviewed interim net profits net of any foreseeable charge or dividend	b	(12,049)		(12,049)
6	**Common equity tier 1 capital before regulatory adjustments**		22,741		22,741
	Common equity tier 1 capital: regulatory adjustments				
7	Additional value adjustments[1]		(623)		(623)
8	Intangible assets (net of related deferred tax liability)	e	(1,970)		(1,970)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	f	(40)		(40)
11	Fair value reserves related to gains or losses on cash flow hedges	g	7		7
12	Negative amounts resulting from the calculation of expected loss amounts	h	(183)		(183)
14	Gains or losses on liabilities at fair value resulting from changes in own credit standing	i	(79)		(79)
15	Defined benefit pension fund assets	j	(22)		(22)
28	**Total regulatory adjustments to common equity tier 1**		(2,910)		(2,910)
29	**Common equity tier 1 capital**		19,831		19,831
	Additional tier 1 ('AT1') capital: instruments				
30	Capital instruments and the related share premium accounts		2,403		2,403
31	– classified as equity under IFRSs	k	2,403		2,403
33	Amount of qualifying items and the related share premium accounts subject to phase out from AT1	l	866	(866)	–
34	Qualifying tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties	m	26	–	26
36	**Additional tier 1 capital before regulatory adjustments**		3,295	(866)	2,429
	Additional tier 1 capital: regulatory adjustments				
37	Direct and indirect holdings of own AT1 instruments[2]		(47)		(47)
43	**Total regulatory adjustments to additional tier 1 capital**		(47)	–	(47)
44	**Additional tier 1 capital**		3,248	(866)	2,382
45	**Tier 1 capital (T1 = CET1 + AT1)**		23,079	(866)	22,213

Table 6 : Own funds disclosure (continued)

Ref*		Ref †	At 31 Dec 2018 £m	CRD IV prescribed residual amount £m	Final CRD IV text £m
	Tier 2 capital: instruments and provisions				
46	Capital instruments and the related share premium accounts	*n*	**13,962**		**13,962**
47	Amount of qualifying items and the related share premium accounts subject to phase out from T2	*o*	**881**	**(881)**	**—**
48	Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in CET1 or AT1) issued by subsidiaries and held by third parties	*p, q*	**152**	**(107)**	**45**
49	– *of which:* *instruments issued by subsidiaries subject to phase out*	*q*	***107***	***(107)***	**—**
51	**Tier 2 capital before regulatory adjustments**		**14,995**	**(988)**	**14,007**
	Tier 2 capital: regulatory adjustments				
52	Direct and indirect holdings of own T2 instruments[2]		**(31)**		**(31)**
55	Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions)	*r*	**(372)**	**—**	**(372)**
57	**Total regulatory adjustments to tier 2 capital**		**(403)**	**—**	**(403)**
58	**Tier 2 capital**		**14,592**	**(988)**	**13,604**
59	**Total capital (TC = T1 + T2)**		**37,671**	**(1,854)**	**35,817**
60	**Total risk-weighted assets**		**143,875**		**143,875**
	Capital ratios and buffers				
61	Common equity tier 1		**13.8%**		**13.8%**
62	Tier 1		**16.0%**		**15.4%**
63	Total capital		**26.2%**		**24.9%**
64	Institution specific buffer requirement		**2.16%**		**2.86%**
65	– capital conservation buffer requirement		**1.88%**		**2.50%**
66	– countercyclical buffer requirement		**0.28%**		**0.36%**
68	Common equity tier 1 available to meet buffers		**9.3%**		**9.3%**
	Amounts below the threshold for deduction (before risk weighting)				
72	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)		**1,383**		
73	Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)		**669**		
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability)		**723**		
	Applicable caps on the inclusion of provisions in tier 2				
77	Cap on inclusion of credit risk adjustments in T2 under standardised approach		**387**		
79	Cap for inclusion of credit risk adjustments in T2 under internal ratings-based approach		**459**		
	Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2013 and 1 Jan 2022)				
82	Current cap on AT1 instruments subject to phase-out arrangements		**926**		
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)		**581**		
84	Current cap on T2 instruments subject to phase-out arrangements		**1,075**		
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)		**103**		

* *The references identify the lines prescribed in the EBA template that are applicable and where there is a value.*
† *The references (a) – (r) identify balance sheet components on page 7 that are used in the calculation of regulatory capital.*
1. *Additional value adjustments are calculated on all assets measured at fair value and subsequently deducted from CET1.*
2. *As advised by the PRA a market making waiver has been applied to the deduction of holdings of own T1 and T2 instruments.*

Leverage ratio

The leverage ratio was introduced into the Basel III framework as a non-risk-based limit, to supplement risk-based capital requirements. It aims to constrain the build-up of excess leverage in the banking sector, introducing additional safeguards against model risk and measurement errors. This ratio has been implemented in the EU for reporting and disclosure purposes but, at this stage, has not been set as a binding requirement.

The PRA's leverage ratio requirement applies at the highest level of UK consolidation. For HSBC, this applies at the Group level and not at the HSBC Bank plc level.

Although there is currently no binding leverage ratio requirement on the group, the risk of excess leverage is managed as part of

HSBC's global risk appetite framework and monitored using a leverage ratio metric within our Risk Appetite Statement ('RAS').

The RAS articulates the aggregate level and types of risk that HSBC is willing to accept in its business activities in order to achieve its strategic business objectives. The RAS is monitored via the risk appetite profile report, which includes comparisons of actual performance against the risk appetite and tolerance thresholds assigned to each metric, to ensure that any excessive risk is highlighted, assessed and mitigated appropriately. The risk appetite profile report is presented monthly to the Risk Management Meeting ('RMM').

For the group, the leverage exposure measure is also calculated and presented to the Asset & Liability Management Committee every month.

Our fully phased-in CRD IV leverage ratio was 3.9% at 31 December 2018, down from 4.0% at 31 December 2017. Fall in tier 1 capital was largely offset by a decrease in the leverage exposure measure, primarily due to a transfer of qualifying exposures to HSBC UK.

Table 7: Summary reconciliation of accounting assets and leverage ratio exposures (LRSum)

		At	
		31 Dec	31 Dec
		2018	2017
Ref*		**£m**	£m
1	Total assets as per published financial statements	**604,958**	818,868
	Adjustments for:		
2	– entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	**(22,679)**	(24,818)
4	– derivative financial instruments	**(61,186)**	(68,615)
5	– securities financing transactions ('SFT')	**(8,350)**	4,860
6	– off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	**52,215**	63,229
EU-6a	– intragroup exposures excluded from the leverage ratio exposure measure	**(517)**	(3,230)
7	– other	**5,560**	(3,074)
8	**Total leverage ratio exposure**	**570,001**	787,220

Table 8: Leverage ratio common disclosure (LRCom)

		At	
		31 Dec	31 Dec
		2018^	2017
Ref*		**£m**	£m
	On-balance sheet exposures (excluding derivatives and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**352,866**	601,675
2	(Asset amounts deducted in determining Tier 1 capital)	**(2,262)**	(10,790)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)**	**350,604**	590,885
	Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	**25,418**	14,616
5	Add-on amounts for potential future exposure ('PFE') associated with all derivatives transactions (mark-to-market method)	**82,721**	71,031
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to IFRSs	**4,269**	3,428
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(13,740)**	(15,245)
8	(Exempted central counterparty ('CCP') leg of client-cleared trade exposures)	**(19,566)**	(3,031)
9	Adjusted effective notional amount of written credit derivatives	**146,075**	141,679
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	**(141,887)**	(137,811)
11	**Total derivative exposures**	**83,290**	74,667
	Securities financing transaction exposures		
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	**250,933**	113,493
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	**(171,313)**	(56,684)
14	Counterparty credit risk exposure for SFT assets	**4,789**	4,860
16	**Total securities financing transaction exposures**	**84,409**	61,669
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	**128,523**	175,514
18	(Adjustments for conversion to credit equivalent amounts)	**(76,308)**	(112,285)
19	**Total off-balance sheet exposures**	**52,215**	63,229
	Exempted exposures		
EU-19	(Exemption of intragroup exposures (solo basis))	**(517)**	(3,230)
	Capital and total exposures		
20	**Tier 1 capital**	**22,213**	31,165
21	**Total leverage ratio exposure**	**570,001**	787,220
22	**Leverage ratio (%)**	**3.9**	4.0
EU-23	Choice of transitional arrangements for the definition of the capital measure	**Fully phased-in**	Fully phased-in

* *The references identify the lines prescribed in the EBA template. Lines represented in this table are those lines which are applicable and where there is a value.*

Capital buffers

The geographical breakdown and institution specific countercyclical buffer disclosure is published annually on the HSBC website www.hsbc.com.

Pillar 1

Pillar 1 covers the capital resources requirements for credit risk, market risk and operational risk. Credit risk includes Counterparty credit risk ('CCR') and securitisation requirements. These requirements are expressed in terms of RWAs.

Risk category	Scope of permissible approaches	Approach adopted by HSBC
Credit risk	The BCBS framework applies three approaches of increasing sophistication to the calculation of Pillar 1 credit risk capital requirements. The most basic level, the standardised ('STD') 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 exposure at default ('EAD') and loss given default ('LGD') to standard supervisory parameters. Finally, the IRB advanced approach allows banks to use their own internal assessment in both determining PD and quantifying EAD and LGD.	For consolidated group reporting, we have adopted the advanced IRB approach for the majority of our business. Some portfolios remain on the standardised or foundation IRB approaches: • pending the issuance of local regulations or model approval; • following the supervisory prescription of a non-advanced approach; or • under exemptions from IRB treatment.
Counterparty credit risk ('CCR')	Four approaches to calculating CCR and determining exposure values are defined by the BCBS: mark-to-market, original exposure, standardised and Internal Model Method ('IMM'). These exposure values are used to determine capital requirements under one of the credit risk approaches; standardised, IRB foundation or IRB advanced.	We use the mark-to-market and IMM approaches for CCR. Details of the IMM permission we have received from the PRA can be found in the Financial Services Register on the PRA website. Our aim is to increase the proportion of positions on IMM over time.
Equity	For the non-trading book, equity exposures can be assessed under standardised or IRB approaches.	For group reporting purposes, all equity exposures are treated under the standardised approach.
Securitisation	The BCBS Framework specifies two approaches 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 Method ('RBM'), the Internal Assessment Approach ('IAA') and the Supervisory Formula Method ('SFM'). Securitisation positions in the trading book are treated within market risk, using the CRD IV standard rules.	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 the IAA and the SFM. We also use the standardised approach for an immaterial amount of non-trading book positions.
Market risk	Market risk capital requirements can be determined under either the standard rules or the Internal Models Approach ('IMA'). The latter involves the use of internal Value at Risk ('VaR') models to measure market risks and determine the appropriate capital requirement. In addition to the VaR models, other internal models include Stressed VaR, Incremental Risk Charge ('IRC') and Comprehensive Risk Measure.	The market risk capital requirement is measured using internal market risk models, where approved by the PRA, or under the standard rules. Our internal market risk models comprise VaR, stressed VaR and IRC. Non-proprietary details of the scope of our IMA permission are available in the Financial Services Register on the PRA website. We are in compliance with the requirements set out in Articles 104 and 105 of the Capital Requirements Regulation.
Operational risk	The BCBS framework allows firms to calculate their operational risk capital requirement under the basic indicator approach, the standardised approach or the advanced measurement approach.	We currently use the standardised approach in determining our operational risk capital requirement. We are in the process of implementing an operational risk model, which we will use for economic capital calculation purposes.

Pillar 2 and ICAAP

Pillar 2

We conduct an annual internal capital adequacy assessment process ('ICAAP') to determine a forward-looking assessment of our capital requirements given our business strategy, risk profile, risk appetite and capital plan. This process incorporates the group's risk management processes and governance framework. As part of our ICAAP, a range of stress tests are applied to our base capital plan. Coupled with our economic capital framework and other risk management practices, these are used to assess our internal capital adequacy requirements and inform our view of our internal capital planning buffer. The ICAAP is formally approved by the Board, which has the ultimate responsibility for the effective management of risk and approval of HSBC's risk appetite.

The ICAAP is reviewed by the PRA as part of its supervisory review and evaluation process ('SREP'), which occurs periodically to enable the regulator to define the individual capital guidance ('ICG') or minimum capital requirements for the group, and to define the PRA buffer, where required. The PRA buffer is not intended to duplicate the CRD IV buffers and, where necessary, will be set according to the vulnerability of a bank in a stress scenario, as assessed through the annual PRA stress testing exercise.

The processes of internal capital adequacy assessment and supervisory review lead to a final determination by the PRA of ICG and any PRA buffer 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 any requirements for risk categories not captured by Pillar 1. The risk categories to be covered under Pillar 2A depend on the specific circumstances of a firm and the nature and scale of its business.

Pillar 2B consists of guidance from the PRA on 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 PRA buffer 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 the PRA's view of a firm's options and capacity to protect its capital position under stress, for instance through capital generation. Where the PRA assesses a firm's risk management and governance to be significantly weak, it may also increase the PRA buffer to cover the risks posed by those weaknesses until they are addressed. The PRA buffer is intended to be drawn upon in times of stress, and its use is not of itself a breach of capital requirements that would trigger automatic restrictions on distributions. In specific circumstances, the PRA should agree a plan with a firm for its restoration over an agreed timescale.

Internal capital adequacy assessment

The Board approves the group ICAAP, and together with RMM, it 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 that the group 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.

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 and trading activities, and to a 99.5% level of confidence for our insurance activities and pension risks.

The ICAAP and its constituent economic capital calculations are examined by the PRA as part of its supervisory review and evaluation process. This examination informs the regulator's view of our Pillar 2 capital requirements.

A strong level of integration between our risk and our capital management framework helps to optimise our response to business demand for regulatory and economic capital. Risks that are explicitly assessed through economic capital are credit risk, including CCR, market and operational risk, non-trading book interest rate risk, insurance risk, pension risk, residual risk and structural foreign exchange risk.

Credit risk

Overview

Credit risk is the risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises principally from direct lending, trade finance and leasing business, but also from off-balance sheet products, such as guarantees and credit derivatives, and from the group's holdings of debt and other securities.

The tables below set out details of the group's credit risk exposures by exposure class and approach.

Further explanation of the group's approach to managing credit risk (including details of the group's past due and impaired exposure, and its approach to credit risk impairment) can be found:

- *on pages 35 to 51 of the HSBC Bank plc* Annual Report and Accounts *2018;*
- *on pages 79 to 80 of the HSBC Holdings plc* Annual Report and Accounts *2018; and*
- *on pages 20 to 54 of the HSBC Holdings plc* Pillar 3 Disclosures 31 December 2018*.*

Table 9: Credit risk exposure – summary (CRB-B)

	Footnotes	Net carrying values	Average net carrying values[3]	RWAs^	Capital required^
		£m	£m	£m	£m
IRB advanced approach		181,705	313,462	44,315	3,545
– central governments and central banks		19,293	20,967	2,420	194
– institutions		13,521	12,929	3,196	256
– corporates	1	126,154	169,964	35,732	2,859
– total retail		22,737	109,602	2,967	236
– *of which:*					
secured by mortgages on immovable property – small– and medium–sized enterprises ('SME')		465	42,972	309	24
secured by mortgages on immovable property non-SME		4,530	19,859	648	52
qualifying revolving retail		559	23,277	36	3
other SME		1,518	4,675	607	48
other non-SME		15,665	18,819	1,367	109
IRB securitisation positions		15,954	17,746	4,147	332
IRB non-credit obligation assets		3,300	5,761	1,284	103
IRB foundation approach		28,581	30,799	11,558	925
– central governments and central banks		—	—	4	—
– institutions		—	7	46	4
– corporates		28,581	30,792	11,508	921
Standardised approach		118,704	154,832	27,518	2,200
– central governments and central banks		68,894	99,285	1,831	146
– regional governments or local authorities		1,927	1,904	—	—
– public sector entities		4,111	5,036	9	1
– international organisations		1,256	1,484	—	—
– institutions		5,723	6,032	1,309	105
– corporates		25,769	28,921	14,251	1,140
– retail		1,367	2,121	395	31
– secured by mortgages on immovable property		3,042	3,358	1,064	85
– exposures in default		521	641	632	50
– items associated with particularly high risk		3,284	2,462	4,911	393
– securitisation positions		517	493	541	43
– collective investments undertakings ('CIU')		19	26	19	2
– equity	2	1,282	913	2,285	183
– other items		992	2,156	271	21
At 31 Dec 2018		348,244	522,600	88,822	7,105

1 *Corporates includes specialised lending exposures which are reported in more detail in Table 13.*
2 *This includes investments in insurance companies that are risk weighted at 250%.*
3 *Average net carrying values are calculated by aggregating net carrying values of the last five quarters and dividing by five.*

Table 10: Geographical breakdown of exposures (CRB-C)

		Net carrying values[1,2]						
			Of which:					
		Europe	United Kingdom	France	Germany	Netherlands	Other Europe	Asia
		£m	£m	£m	£m	£m	£m	
	IRB approach exposure classes							
1	Central governments and central banks	1,373	–	–	–	–	1,373	2,566
2	Institutions	10,179	4,452	1,121	636	444	3,526	674
3	Corporates	132,678	44,392	36,051	17,489	5,870	28,876	3,154
4	Retail	22,621	2,700	19,537	1	9	374	5
6	**Total IRB approach**	166,851	51,544	56,709	18,126	6,323	34,149	6,399
	Standardised approach exposure classes							
7	Central governments and central banks	68,894	24,180	31,126	3,971	6,270	3,347	–
8	Regional governments or local authorities	1,927	–	8	1,917	–	2	–
9	Public sector entities	4,101	–	105	3,779	–	217	–
11	International organisations	–	–	–	–	–	–	–
12	Institutions	1,830	1,577	–	–	–	253	1,043
13	Corporates	19,794	1,816	3,239	1,136	2,661	10,942	407
14	Retail	1,350	7	281	179	22	861	–
15	Secured by mortgages on immovable property	2,990	690	346	–	–	1,954	1
16	Exposures in default	407	3	24	29	23	328	–
17	Items associated with particularly high risk	2,250	1,005	422		–	823	–
20	Collective investment undertakings ('CIU')	19	–	–	5	–	14	–
21	Equity	1,217	1,079	87	41	–	10	1
22	Other items	991	486	466	1	–	38	1
23	**Total standardised approach**	105,770	30,843	36,104	11,058	8,976	18,789	1,453
24	**At 31 Dec 2018**	272,621	82,387	92,813	29,184	15,299	52,938	7,852

		Net carrying values[1,2]						
				Of which:				
		MENA	North America	United States of America	Other countries	Latin America	Other geographical areas	Total
		£m	£m	£m	£m		£m	£m
	IRB approach exposure classes							
1	Central governments and central banks	2,731	9,366	9,269	97	6	3,251	19,293
2	Institutions	2,168	457	355	102	10	33	13,521
3	Corporates	5,315	12,526	9,926	2,600	1,062	–	154,735
4	Retail	2	108	16	92	1	–	22,737
6	**Total IRB approach**	10,216	22,457	19,566	2,891	1,079	3,284	210,286
	Standardised approach exposure classes							
7	Central governments and central banks	–	–	–	–		–	68,894
8	Regional governments or local authorities	–	–	–	–		–	1,927
9	Public sector entities	10	–	–	–		–	4,111
11	International organisations	–	–	–	–		1,256	1,256
12	Institutions	189	2,406	2,159	247	255	–	5,723
13	Corporates	3,751	1,459	912	547	358	–	25,769
14	Retail	2	14	–	14	1	–	1,367
15	Secured by mortgages on immovable property	3	35	–	35	13	–	3,042
16	Exposures in default	55	50	–	50	9	–	521
17	Items associated with particularly high risk	13	1,021	423	598		–	3,284
20	Collective investment undertakings ('CIU')	–	–	–	–	–	–	19
21	Equity	–	64	24	40	–	–	1,282
22	Other items	–	–	–	–	–	–	992
23	**Total standardised approach**	4,023	5,049	3,518	1,531	636	1,256	118,187
24	**At 31 Dec 2018**	14,239	27,506	23,084	4,422	1,715	4,540	328,473

1 *Amounts shown by geographical region in this table are based on the country of residence of the counterparty.*
2 *Securitisation positions and non-credit obligation assets are not included in this table.*

Table 11: Concentration of exposures by industry or counterparty types (CRB-D)

	Net carrying values[1]	Agriculture £m	Mining & oil extrac-tion £m	Manufac-turing £m	Utilities £m	Water supply £m	Construction £m	Wholesale & retail trade £m	Transpor-tation & storage £m	Accom-modation & food services £m	Infor-mation & commun-ication £m	Financial & insurance £m
	IRB approach exposure classes											
1	Central governments and central banks	—	—	11	—	—	—	—	—	—	—	2,836
2	Institutions	—	—	—	—	—	—	—	—	—	—	13,438
3	Corporates	169	6,594	35,687	5,919	641	2,781	22,830	8,692	1,250	2,199	23,854
4	Retail	16	2	366	5	2	89	485	70	43	2	50
6	**Total IRB approach**	185	6,596	36,064	5,924	643	2,870	23,315	8,762	1,293	2,201	40,178
	STD approach exposure classes											
7	Central governments and central banks	—	—	45	—	—	—	—	—	—	—	56,188
8	Regional governments or local authorities	—	—	—	—	—	—	—	—	—	—	186
9	Public sector entities	—	—	4	47	9	—	—	10	—	—	3,645
10	Multilateral development banks	—	—	—	—	—	—	—	—	—	—	—
11	International organisations	—	—	—	—	—	—	—	—	—	—	—
12	Institutions	—	—	—	—	—	—	—	—	—	—	5,723
13	Corporates	136	555	6,630	1,674	45	1,403	2,053	1,585	452	438	3,157
14	Retail	7	1	37	—	—	18	16	30	3	—	5
15	Secured by mortgages on immovable property	—	—	—	—	—	—	—	—	—	—	—
16	Exposures in default	4	—	101	33	—	83	40	10	8	—	58
17	Items associated with particularly high risk	3	—	—	14	—	—	—	—	—	—	3,082
20	Collective investment undertakings ('CIU')	—	—	—	—	—	—	—	—	—	—	19
21	Equity exposures	—	—	17	—	—	—	—	—	—	—	1,193
22	Other exposures	—	—	—	—	—	—	—	—	—	—	992
23	**Total STD approach**	150	556	6,834	1,768	54	1,504	2,109	1,635	463	438	74,248
24	**At 31 Dec 2018**	335	7,152	42,898	7,692	697	4,374	25,424	10,397	1,756	2,639	114,426

Table 11: Concentration of exposures by industry or counterparty types (CRB-D) (continued)

	Net carrying values[1]	Real estate	Professional activities	Administ-rative service	Public admin & defence	Education	Human health & social work	Arts & entertain-ment	Other services	Personal	Extra-territorial bodies	Total
		£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
	IRB approach exposure classes											
1	Central governments and central banks	–	–	–	12,989	–	184	–	–	–	3,273	19,293
2	Institutions	–	–	6	45	–	–	–	–	–	32	13,521
3	Corporates	9,752	3,910	25,757	1,088	48	346	694	2,370	154	–	154,735
4	Retail	483	11	266	–	7	33	29	23	20,755	–	22,737
6	**Total IRB approach**	10,235	3,921	26,029	14,122	55	563	723	2,393	20,909	3,305	210,286
	STD approach exposure classes											
7	Central governments and central banks	–	–	–	12,661	–	–	–	–	–	–	68,894
8	Regional governments or local authorities	–	–	–	1,741	–	–	–	–	–	–	1,927
9	Public sector entities	–	–	–	260	111	25	–	–	–	–	4,111
11	International organisations	–	–	–	–	–	–	–	–	–	1,256	1,256
12	Institutions	–	–	–	–	–	–	–	–	–	–	5,723
13	Corporates	2,041	1,031	2,930	6	7	97	206	252	1,071	–	25,769
14	Retail	31	5	82	–	4	8	6	2	1,112	–	1,367
15	Secured by mortgages on immovable property	–	–	–	–	–	–	–	3	3,039	–	3,042
16	Exposures in default	30	11	27	–	–	2	–	1	113	–	521
17	Items associated with particularly high risk	61	–	124	–	–	–	–	–	–	–	3,284
20	Collective investment undertakings ('CIU')	–	–	–	–	–	–	–	–	–	–	19
21	Equity exposures	1	18	50	–	–	–	–	–	–	3	1,282
22	Other exposures	–	–	–	–	–	–	–	–	–	–	992
23	**Total STD approach**	2,164	1,065	3,213	14,668	122	132	212	258	5,335	1,259	118,187
24	**At 31 Dec 2018**	12,399	4,986	29,242	28,790	177	695	935	2,651	26,244	4,564	328,473

1 *Securitisation positions and non-credit obligation assets are not included in this table.*

Table 12: Maturity of on-balance sheet exposures (CRB-E)

		Net carrying values[1]					
		On demand	Less than 1 year	Between 1 and 5 years	More than 5 years	Undated	Total
		£m	£m	£m	£m	£m	£m
	IRB approach exposure classes						
1	Central governments and central banks	960	5,001	9,806	2,705	–	18,472
2	Institutions	5,278	2,318	1,569	466	–	9,631
3	Corporates	25,391	15,154	23,037	7,376	–	70,958
4	Retail	533	292	2,399	17,324	–	20,548
6	**Total IRB approach**	32,162	22,765	36,811	27,871	–	119,609
	Standardised approach exposure classes						
7	Central governments and central banks	26,662	27,850	9,627	3,392	721	68,252
8	Regional governments or local authorities	–	156	1,093	678	–	1,927
9	Public sector entities	–	1,313	1,957	787	–	4,057
11	International organisations	–	626	278	352	–	1,256
12	Institutions	56	4,004	21	947	–	5,028
13	Corporates	1,635	6,098	5,441	1,441	–	14,615
14	Retail	108	55	295	158	–	616
15	Secured by mortgages on immovable property	–	69	409	2,563	–	3,041
16	Exposures in default	63	147	173	102	–	485
17	Items associated with particularly high risk	–	17	506	–	1,076	1,599
20	Collective investment undertakings	–	–	–	–	19	19
21	Equity	–	7	1	–	1,273	1,281
22	Other items	–	839	1	–	151	991
23	**Total standardised approach**	28,524	41,181	19,802	10,420	3,240	103,167
24	**At 31 Dec 2018**	60,686	63,946	56,613	38,291	3,240	222,776

1 *Securitisation positions and non-credit obligation assets are not included in this table.*

Table 13: Specialised lending on slotting approach (CR10)

Regulatory categories	Remaining maturity	On-balance sheet amount £m	Off-balance sheet amount £m	Risk weight %	Exposure amount £m	RWAs £m	Expected loss £m
Category 1 – Strong	Less than 2.5 years	**1,881**	**229**	**0.5**	**1,959**	**980**	**–**
	Equal to or more than 2.5 years	**1,124**	**270**	**0.7**	**1,210**	**847**	**5**
Category 2 – Good	Less than 2.5 years	**265**	**19**	**0.7**	**269**	**188**	**1**
	Equal to or more than 2.5 years	**644**	**114**	**0.9**	**689**	**618**	**5**
Category 3 – Satisfactory	Less than 2.5 years	**96**	**7**	**1.15**	**99**	**114**	**3**
	Equal to or more than 2.5 years	**96**	**31**	**1.15**	**116**	**133**	**3**
Category 4 – Weak	Less than 2.5 years	**2**	**–**	**2.5**	**2**	**5**	**–**
	Equal to or more than 2.5 years	**14**	**1**	**2.5**	**18**	**45**	**1**
Category 5 – Default	Less than 2.5 years	**28**	**2**	**–**	**43**	**–**	**22**
	Equal to or more than 2.5 years	**32**	**–**	**–**	**37**	**–**	**19**
At 31 Dec 2018	Less than 2.5 years	**2,272**	**257**		**2,372**	**1,287**	**26**
	Equal to or more than 2.5 years	**1,910**	**416**		**2,070**	**1,643**	**33**

Past due but not impaired exposures, impaired exposures and credit risk adjustments ('CRA')

We analyse past due but not impaired, impaired exposures and impairment allowances, and other credit risk provisions using accounting values on a regulatory consolidation basis.

Our approach for determining impairment allowances is explained on pages 28 and 83 of the HSBC Bank plc Annual Report and Accounts 2018*.*

Under the accounting standards currently adopted by HSBC, impairment allowances, value adjustments and credit-related provisions for off-balance sheet amounts are treated as specific CRAs.

Table 14: Amount of past due, impaired exposures and related allowances by industry sector and geographical region[1]

	Footnotes	United Kingdom £m	Continental Europe £m	Other £m	Total £m
At 31 Dec 2018					
Past due but not impaired exposures		**10**	**290**	**–**	**300**
– personal		**7**	**156**	**–**	**163**
– corporate and commercial		**3**	**134**	**–**	**137**
– financial		**–**	**–**	**–**	**–**
Impaired exposures		**926**	**1,748**	**115**	**2,789**
– personal		**20**	**510**	**1**	**531**
– corporate and commercial		**860**	**1,205**	**114**	**2,179**
– financial		**46**	**33**	**–**	**79**
Impairment allowances and other credit risk provisions	2	**(573)**	**(852)**	**(40)**	**(1,465)**
– personal		**(6)**	**(199)**	**–**	**(205)**
– corporate and commercial		**(538)**	**(649)**	**(39)**	**(1,226)**
– financial		**(29)**	**(4)**	**(1)**	**(34)**
At 31 Dec 2017					
Past due but not impaired exposures		608	363	6	977
– personal		491	116	–	607
– corporate and commercial		114	240	1	355
– financial		3	7	5	15
Impaired exposures		4,612	1,598	148	6,358
– personal		1,051	405	2	1,458
– corporate and commercial		2,885	1,191	146	4,222
– financial		676	2	–	678
Impairment allowances and other credit risk provisions	2	(1,485)	(791)	(20)	(2,296)
– personal		(297)	(138)	(2)	(437)
– corporate and commercial		(1,055)	(652)	(18)	(1,725)
– financial		(133)	(1)	–	(134)

1 *Amounts shown by geographical region in this table are based on the country of the lender.*
2 *Figures presented under IAS 39 (at 31 December 2017) and using the EU's transitional arrangements for IFRS 9 (at 31 December 2018).*

Table 15: Movement in specific credit risk adjustments by industry sector and by geographical region[1]

	Footnotes	United Kingdom £m	Continental Europe £m	Other £m	Total £m
Specific credit risk adjustments at 31 Dec 2017	2	1,485	791	20	2,296
Impact on transition to IFRS 9		689	65	12	766
Specific credit risk adjustments at 1 Jan 2018	3	2,174	856	32	3,062
Amounts written off		(355)	(95)	(7)	(457)
– personal		(134)	(16)	–	(150)
– corporate and commercial		(128)	(79)	(7)	(214)
– financial		(93)	–	–	(93)
Recoveries of amounts written off in previous years		67	4	–	71
– personal		48	2	–	50
– corporate and commercial		19	2	–	21
– financial		–	–	–	–
Charge to income statement		218	56	14	288
– personal		141	12	–	153
– corporate and commercial		104	57	14	175
– financial		(27)	(13)	–	(40)
Amounts transferred to HSBC UK Bank plc	4	(1,404)	–	–	(1,404)
Exchange and other movements		(127)	31	1	(95)
Specific credit risk adjustments at 31 Dec 2018	3	573	852	40	1,465

1 Amounts shown by geographical region in this table are based on the country of the lender.
2 Figures presented under IAS 39.
3 Figures presented using the EU's transitional arrangements for IFRS 9.
4 On 1 July 2018 HSBC Bank plc's UK Retail and SME operations were legally separated into a ring-fenced bank, HSBC UK Bank plc. This demerger was carried out to meet the Group's obligation to ring-fence these activities from its wholesale and investment banking activities by 1 January 2019, in accordance with the UK Banking Reform Act.

Expected loss ('EL') and credit risk adjustments

We analyse credit loss experience in order to assess the performance of our risk measurement and control processes, and to inform our understanding of the implications for risk and capital management of dynamic changes occurring in the risk profile of our exposures.

When comparing regulatory EL with measures of expected credit losses ('ECL') under IFRS 9, differences in the definition and scope of each should be considered. These differences can give rise to material differences in the way economic, business and methodological drivers are reflected quantitatively in the accounting and regulatory measures of loss.

In general HSBC calculates ECL using three main components, a probability of default, a loss given default, and the exposure at default.

Expected credit losses include impairment allowances (or provision in the case of commitments and guarantees) for the 12-month ECL ('12-month ECL') and lifetime ECL, and on financial assets that are considered to be in default or otherwise credit impaired.

ECL resulting from default events that are possible within the next 12 months are recognised for financial instruments in stage 1.

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.

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.

ECL resulting from default events that are possible beyond 12 months ('Life time ECL') are recognised for financial instruments in stages 2 & 3.

Change in expected credit losses and other credit impairment charges represent the movement in the ECL during the year including write-offs, recoveries and foreign exchange. EL represents the one-year regulatory expected loss accumulated in the book at the balance sheet date.

Credit risk adjustments ('CRAs') encompass the impairment allowances or provisions balances, and changes in expected credit losses and other credit impairment charges.

Table 16 sets out for IRB credit exposures the EL, CRA balances and actual loss experience reflected in the charges for CRAs.

HSBC leverages the Basel IRB framework where possible, with recalibration to meet the differing IFRS 9 requirements as follows:

Model	Regulatory capital	IFRS 9
PD	• Through the cycle (represents long-run average PD throughout a full economic cycle) • The definition of default includes a backstop of 90+ days past due, although this has been modified to 180+ days past due for some portfolios, particularly UK and US mortgages	• Point in time (based on current conditions, adjusted to take into account estimates of future conditions that will impact PD) • Default backstop of 90+ days past due for all portfolios
EAD	• Cannot be lower than current balance	• Amortisation captured for term products
LGD	• Downturn LGD (consistent losses expected to be suffered during a severe but plausible economic downturn) • Regulatory floors may apply to mitigate risk of underestimating downturn LGD due to lack of historical data • Discounted using cost of capital • All collection costs included	• Expected LGD (based on estimate of loss given default including the expected impact of future economic conditions such as changes in value of collateral) • No floors • Discounted using the original effective interest rate of the loan • Only costs associated with obtaining/selling collateral included
Other		• Discounted back from point of default to balance sheet date

Table 16: IRB expected loss and CRA – by exposure class

	2018			2017		
		CRA[1]			CRA[1]	
	Expected loss[1]	**Balances**	**Charge for the year**	Expected loss[1]	Balances	Charge for the year
	£m	**£m**	**£m**	£m	£m	£m
IRB exposure classes						
Central governments and central banks	**4**	**7**	**(2)**	4	1	—
Institutions	**11**	**7**	**(2)**	10	1	1
Corporates	**902**	**787**	**77**	1,820	1,385	463
Retail	**298**	**283**	**227**	948	602	132
– secured by mortgages on immovable property SME	**30**	**28**	**36**	8	3	—
– secured by mortgages on immovable property non-SME	**44**	**42**	**(2)**	117	157	20
– qualifying revolving retail	**2**	**4**	**152**	235	116	98
– other SME	**143**	**127**	**265**	391	205	5
– other non-SME	**79**	**82**	**(224)**	197	121	9
At 31 Dec	**1,215**	**1,084**	**300**	2,782	1,989	596

Table 17: IRB expected loss and CRA – by region[2]

	2018			2017		
		CRA[1]			CRA[1]	
	Expected loss[1]	**Balances**	**Charge for the year**	Expected loss[1]	Balances	Charge for the year
	£m	**£m**	**£m**	£m	£m	£m
United Kingdom	**503**	**519**	**242**	2,114	1,452	505
Continental Europe	**706**	**554**	**56**	664	537	91
Other	**6**	**11**	**2**	4	—	—
At 31 Dec	**1,215**	**1,084**	**300**	2,782	1,989	596

1 *Excludes securitisation exposures because EL is not calculated for this exposure class.*
2 *Amounts shown by geographical region in this table are based on the country of the lender.*

Risk mitigation

Mitigation of credit risk is a key aspect of effective risk management. Specific, detailed policies cover the acceptability, structuring and terms of various types of business with regard to the availability of credit risk mitigation; for example in the form of collateral security. These policies, together with the setting of suitable valuation parameters, are subject to regular review to ensure that they are supported by empirical evidence and continue to fulfil their intended purpose.

Collateral

The most common method of mitigating credit risk is to take collateral. In our retail residential and commercial real estate ('CRE') businesses, a mortgage over the property is usually taken to help secure claims. Physical collateral is also taken in various forms of specialised lending and leasing transactions where income from the physical assets that are financed is also the principal source of facility repayment. In the commercial and industrial sectors, charges are created over business assets such as premises, stock and debtors. Loans to private banking clients may be made against a pledge of eligible marketable securities, cash or real estate.

Further information regarding charges held over residential and commercial property is provided on pages 109 and 113 of the HSBC Holdings plc Annual Report and Accounts 2018*.*

Financial collateral

In the institutional sector, trading facilities are supported by charges over financial instruments such, as cash, debt securities and equities. Financial collateral in the form of marketable securities is used in much of the group's over-the-counter ('OTC') derivatives activities, and in SFTs such as repos, reverse repos, securities lending and borrowing. Netting is used extensively and is a prominent feature of market standard documentation.

In the non-trading book, we provide customers with working capital management products. Some of these products have loans and advances to customers and customer accounts where we have rights of offset, and comply with the regulatory requirements for on-balance sheet netting. Under on-balance sheet netting, the customer accounts are treated as cash collateral and the effects of this collateral are incorporated in our LGD estimates. For risk management purposes, the net exposures are subject to limits that are monitored, and the relevant customer agreements are subject to review and update, as necessary, to ensure the legal right of offset remains appropriate.

Other forms of Credit Risk Mitigation

Facilities to SMEs are commonly granted against guarantees given by their owners and/or directors. Guarantees may be taken from third parties where the group extends facilities without the benefit of any alternative form of security, e.g. where it issues a bid or performance bond in favour of a non-customer at the request of another bank.

Our GB&M business utilises credit risk mitigation to manage the credit risk of its portfolios, with the goal of reducing concentrations in individual names, sectors or portfolios. The techniques in use include credit default swap ('CDS') purchases, structured credit notes and securitisation structures. Buying credit protection creates credit exposure against the protection provider, which is monitored as part of the overall credit exposure to them. Where applicable, the transaction is entered into directly with a central clearing house counterparty, otherwise our exposure to CDS protection providers is diversified among mainly banking counterparties with strong credit ratings.

In our corporate lending, we also take guarantees from corporates and Export Credit Agencies. Corporates normally provide guarantees as part of a parent/subsidiary or common parent relationship and span a number of credit grades. Export Credit Agencies will normally be investment grade.

Policy and procedures

Policies and procedures govern the protection of our position from the outset of a customer relationship; for instance, in requiring standard terms and conditions or specifically agreed documentation permitting the offset of credit balances against debt obligations, and through controls over the integrity, current valuation and, if necessary, realisation of collateral security.

Valuing collateral

Valuation strategies are established to monitor collateral mitigants to ensure that they continue to provide the anticipated secure secondary repayment source. Market trading activities, such as collateralised OTC derivatives and SFTs, typically include daily valuations in support of margining arrangements. In the residential mortgage business, HSBC policy prescribes revaluation at intervals of up to three years, or more frequently where market conditions are subject to significant change. Residential property collateral values are determined through a combination of professional appraisals, house price indices or statistical analysis.

Local market conditions determine the frequency of valuation for CRE. Revaluations are sought where, for example, as part of the regular credit assessment of the obligor, material concerns arise in relation to the performance of the collateral. CRE revaluation also commonly occurs where a decline in the obligor's credit quality gives cause for concern that the principal payment source may not fully meet the obligation.

Recognition of risk mitigation under the IRB approach

Within an IRB approach, risk mitigants are considered in two broad categories: first, those that reduce the intrinsic PD of an obligor; and second, those that affect the estimated recoverability of obligations and thus LGD.

The first typically include full parental guarantees – where one obligor within a group of companies guarantees another. This is usually factored into the estimate of the latter's PD, as it is expected that the guarantor will intervene to prevent a default. PD estimates are also subject to a 'sovereign ceiling', constraining the risk ratings assigned to obligors in higher risk countries if only partial parental support exists. In certain jurisdictions, typically those on the Foundation IRB approach, certain types of third-party guarantee are also recognised through substitution of the obligor's PD by the guarantor's PD.

In the second category, LGD estimates are affected by a wider range of collateral, including cash, charges over real estate property, fixed assets, trade goods, receivables and floating charges such as mortgage debentures. Unfunded mitigants, such as third-party guarantees, are also taken into consideration in LGD estimates where there is evidence that they reduce loss expectation.

The main providers of guarantees are banks, other financial institutions and corporates, the latter typically in support of subsidiaries of their company group. Across HSBC, the nature of such customers and transactions is very diverse and the creditworthiness of guarantors accordingly spans a wide spectrum. The creditworthiness of providers of unfunded credit risk mitigation is taken into consideration as part of the guarantor's risk profile when; for example, assessing the risk of other exposures such as direct lending to the guarantor. Internal limits for such contingent exposure are approved in the same way as direct exposures.

EAD and LGD values, in the case of individually assessed exposures, are determined by reference to regionally approved internal risk parameters based on the nature of the exposure. For retail portfolios, credit risk mitigation data is incorporated into the internal risk parameters for exposures and feeds into the calculation of the EL band value summarising both customer delinquency and product or facility risk. Credit and credit risk mitigation data form inputs submitted by all HSBC offices to centralised databases. A range of collateral recognition approaches are applied to IRB capital treatments:

- unfunded protection, which includes credit derivatives and guarantees, is reflected through adjustment or determination of PD or LGD;
- eligible financial collateral is taken into account in LGD models (under Advanced IRB) or by adjusting regulatory LGD values (under Foundation IRB). The adjustment to LGD for the latter is based on the degree to which the exposure value would be adjusted if the Financial Collateral Comprehensive Method were applied; and
- for all other types of collateral, including real estate, the LGD for exposures calculated under the IRB advanced approach is calculated by models. For IRB foundation, base regulatory LGDs are adjusted depending on the value and type of the asset taken as collateral relative to the exposure. The types of eligible mitigant recognised under the IRB foundation approach are more limited.

Table 18 below sets out, for IRB exposures, the exposure value and the effective value of credit risk mitigation expressed as the exposure value covered by the credit risk mitigant.

Recognition of risk mitigation under the standardised approach

Where credit risk mitigation is available in the form of an eligible guarantee, non-financial collateral or credit derivatives, the exposure is divided into covered and uncovered portions. The covered portion, which is determined after applying an appropriate 'haircut' for currency and maturity mismatches (and for omission of restructuring clauses for credit derivatives, where appropriate) to the amount of the protection provided, attracts the risk weight of the protection provider. The uncovered portion attracts the risk weight of the obligor. For exposures fully or partially covered by eligible financial collateral, the value of the exposure is adjusted under the financial collateral comprehensive method using supervisory volatility adjustments, including those arising from currency mismatch, which are determined by the specific type of collateral (and, in the case of eligible debt securities, their credit quality) and its liquidation period. The adjusted exposure value is subject to the risk weight of the obligor.

Table 19 sets out the credit risk mitigation for exposures under the standardised approach, expressed as the exposure value covered by the credit risk mitigant.

Table 18: IRB exposure – credit risk mitigation

	2018			2017		
	Exposure value covered by eligible financial and other collateral	**Exposure value covered by credit derivatives or guarantees**	**Total**	Exposure value covered by eligible financial and other collateral	Exposure value covered by credit derivatives or guarantees	Total
	£m	**£m**	**£m**	£m	£m	£m
Exposures under the IRB advanced approach		**26,307**	**26,307**		24,510	24,510
– central governments and central banks		**720**	**720**		553	553
– institutions		**55**	**55**		1	1
– corporates		**13,132**	**13,132**		11,952	11,952
– retail		**12,400**	**12,400**		12,004	12,004
Exposures under the IRB foundation approach	**611**	**2,553**	**3,164**	603	1,265	1,868
– Corporates	**611**	**2,553**	**3,164**	603	1,265	1,868
At 31 Dec	**611**	**28,860**	**29,471**	603	25,775	26,378

Table 19: Standardised exposure – credit risk mitigation

		2018			2017		
		Exposure value covered by eligible financial and other collateral	**Exposure value covered by credit derivatives or guarantees**	**Total**	Exposure value covered by eligible financial and other collateral	Exposure value covered by credit derivatives or guarantees	Total
	Footnotes	**£m**	**£m**	**£m**	£m	£m	£m
Exposures under the standardised	*1*						
Central governments and central banks	*2,4*	**36**	**195**	**231**	217	637	854
Corporates		**1,472**	**3,222**	**4,694**	850	2,637	3,487
Retail		**210**	**2**	**212**	319	825	1,144
Secured by mortgages on immovable property		**38**	**—**	**38**	106	10	116
Exposures in default		**2**	**52**	**54**	16	13	29
Items associated with particularly high risk	*3*	**1**	**—**	**1**	8	—	8
Public sector entities	*4*	**6**	**—**	**6**	—	—	—
At 31 Dec		**1,765**	**3,471**	**5,236**	1,516	4,122	5,638

1 *This table includes both on and off balance sheet exposures.*
2 *Deferred tax assets are excluded from the exposure.*
3 *Equities are excluded from the exposure.*
4 *Standardised exposures to EEA 'regional governments and local authorities' and 'public sector entities' are reported separately in 2018 where applicable. In previous years, these exposures were grouped with 'central governments and central banks'.*

Counterparty credit risk

Overview

Counterparty credit risk is the risk that the counterparty to a transaction may default before completing the satisfactory settlement of the transaction. It arises on derivatives, securities financing transactions and exposures to central counterparties ('CCP') in both the trading and non-trading books.

The table below sets out details of the group's counterparty credit risk exposures by exposure class and approach.

Further explanation of the group's approach to managing counterparty credit risk can be found:

- *on page 51 of the HSBC Bank plc* Annual Report and Accounts 2018*;*
- *on page 113 of the HSBC Holdings plc* Annual Report and Accounts 2018*; and*
- *on pages 55 to 58 of the HSBC Holdings plc* Pillar 3 Disclosures 31 December 2018*.*

Table 20: Counterparty credit risk – RWAs by exposure class and product

	Footnotes	2018		2017	
		RWAs	**Capital required**	RWAs	Capital required
		£m	**£m**	£m	£m
By exposure class					
IRB advanced approach		**16,923**	**1,355**	15,680	1,254
– central governments and central banks		**396**	**32**	539	43
– institutions		**6,543**	**523**	5,218	417
– corporates		**9,984**	**800**	9,923	794
IRB foundation approach		**1,312**	**105**	1,245	100
– corporates		**1,312**	**105**	1,245	100
Standardised approach		**2,679**	**214**	3,237	259
– central governments and central banks		**26**	**2**	—	—
– institutions		**2,326**	**186**	2,820	226
– corporates		**327**	**26**	417	33
CVA advanced		**2,438**	**195**	2,294	184
CVA standardised		**806**	**64**	1,083	86
CCP standardised		**511**	**41**	479	38
By product					
– derivatives (OTC and exchange-traded derivatives)		**14,953**	**1,197**	14,842	1,187
– SFTs		**5,448**	**436**	4,333	347
– other	1	**839**	**67**	1,215	97
– CVA advanced		**2,438**	**195**	2,294	184
– CVA standardised		**806**	**64**	1,083	86
– CCP default funds	2	**185**	**15**	251	20
At 31 Dec		**24,669**	**1,974**	24,018	1,921

1 *Includes free deliveries not deducted from regulatory capital and settlements.*
2 *Default fund contributions are cash balances posted to CCPs by all members.*

Market risk

Overview

Market risk is the risk that movements in market risk factors, including foreign exchange rates, commodity prices, interest rates, credit spreads and equity prices, will reduce the group's income or the value of its portfolios. Market risk is measured using internal market risk models where approved by the PRA, PRA approved local VaR models or the standardised approach for position risk under CRD IV.

The tables below sets out details of the bank's market risk exposures by type and approach.

Further explanation of the group's approach to managing market risk can be found:

- *on pages 63 to 65 of the HSBC Bank plc* Annual Report and Accounts 2018*;*
- *on pages 136 to 142 of the HSBC Holdings plc* Annual Report and Accounts 2018*; and*
- *on pages 61 to 66 of the HSBC Holdings plc* Pillar 3 Disclosures 31 December 2018*.*

Table 21: Market risk under standardised approach (MR1)

		At 31 Dec 2018	
		RWAs	Capital required
		£m	£m
	Outright products		
1	Interest rate risk (general and specific)	634	51
2	Equity risk (general and specific)	27	2
4	Commodity risk	36	3
	Options		
6	Delta-plus method	40	3
8	**Securitisation**	1,126	90
9	**Total**	1,863	149

Table 22: Market risk under IMA (MR2-A)

		At 31 Dec 2018	
		RWAs	Capital required
		£m	£m
1	**VaR (higher of values a and b)**	4,408	353
(a)	Previous day's VaR		89
(b)	Average daily VaR		353
2	**Stressed VaR (higher of values a and b)**	6,641	531
(a)	Latest SVaR		135
(b)	Average SVaR		531
3	**Incremental risk charge (higher of values a and b)**	2,991	239
(a)	Most recent IRC value		214
(b)	Average IRC value		239
5	**Other**	1,631	131
6	**Total**	15,671	1,254

Operational risk

Overview

Operational risk is the risk to achieving our strategy or objectives as a result of inadequate or failed internal processes, people and systems, or from external events.

Operational risk is relevant to every aspect of our business. It covers a wide spectrum of issues, such as compliance, operational resilience, legal, security and fraud. Losses arising from breaches of regulation and law, unauthorised activities, error, omission, inefficiency, fraud, systems failure or external events all fall within the definition of operational risk.

We have historically experienced operational risk losses in the following major categories:

- mis-selling of payment protection insurance;
- external criminal activities, including fraud;
- breakdowns in processes/procedures due to human error, misjudgement or malice;
- system failure or non-availability;
- breach of regulatory and/or legislative requirements; and
- information and cyber security.

Further explanation of the group's approach to managing operational risk can be found:

- *on page 31 of the HSBC Bank plc* Annual Report and Accounts 2018*;*
- *on page 84 of the HSBC Holdings plc* Annual Report and Accounts 2018*; and*
- *on pages 67 to 68 of the HSBC Holdings plc* Pillar 3 Disclosures 31 December 2018*.*

Table 23: Operational risk RWAs and capital required

	At 31 Dec			
	2018		2017	
	RWAs £m	Capital required £m	RWAs £m	Capital required £m
Own funds requirement for operational risk	12,850	1,028	23,310	1,865

Other risks

Interest rate risk in the banking book

Interest Rate Risk in the Banking Book ('IRRBB') arises from timing mismatches in the repricing of non-traded assets and liabilities and is the potential adverse impact of changes in interest rates on earnings and capital. The component of IRRBB that can be economically neutralised in the market is transferred to Balance Sheet Management to manage, in accordance with internal transfer pricing rules. In its management of IRRBB, the group aims to balance mitigating the impact of future interest rate movements against the cost of hedging.

Key metrics to monitor the impact of future rate movements on the bank are the projected net interest income sensitivity and economic value of equity ('EVE') sensitivity, under varying interest rate scenarios.

EVE represents the present value of the future banking book cash flows that could be distributed to equity providers under a managed run-off scenario, i.e. the current book value of equity plus the present value of future net interest income in this scenario. EVE sensitivity is the extent to which the EVE value will change due to a specified movement in interest rates, where all other economic variables are held constant.

Further details of our IRRBB may be found on page 31 of the HSBC Bank plc Annual Report and Accounts 2018*.*

Risk management of insurance operations

We operate an integrated bancassurance model which provides insurance products principally for customers with whom we have a banking relationship. Insurance products are sold through all global businesses, but predominantly by RBWM and CMB through our branches and direct channels worldwide.

The insurance contracts we sell relate to the underlying needs of our banking customers, which we can identify from our point-of-sale contacts and customer knowledge. The majority of sales are of savings and investment products and term and credit life contracts. By focusing largely on personal and SME lines of business we are able to optimise volumes and diversify individual insurance risks.

We choose to manufacture these insurance products in HSBC subsidiaries based on an assessment of operational scale and risk appetite. Manufacturing insurance allows us to retain the risks and rewards associated with writing insurance contracts by keeping part of the underwriting profit and investment income within the Group.

Where we do not have the risk appetite or operational scale to be an effective insurance manufacturer, we engage with a handful of leading external insurance companies in order to provide insurance products to our customers through our banking network and direct channels. These arrangements are generally structured with our exclusive strategic partners and earn the Group a combination of commissions, fees and a share of profits.

We distribute insurance products in all of our geographical regions. We have life insurance manufacturing subsidiaries in nine countries including the UK.

We measure the risk profile of our insurance manufacturing businesses using an economic capital approach, where assets and liabilities are measured on a market value basis and a capital requirement is held to ensure that there is less than a one in 200 chance of insolvency over the next year, given the risks that the businesses are exposed to. The methodology for the economic capital calculation is largely aligned to the new pan-European Solvency II insurance capital regulations, which are applicable from 2016.

Subsidiaries engaged in insurance activities are excluded from the regulatory consolidation by excluding assets, liabilities and post-acquisition reserves, leaving the investment of these insurance subsidiaries to be recorded at cost and deducted from CET1 subject to thresholds (amounts below the thresholds are risk-weighted).

Further details of the management of financial risks and insurance risk arising from the insurance operations are provided from page 33 of the HSBC Bank plc Annual Report and Accounts 2018.

Liquidity and funding risk

Strategies and processes in the management of liquidity risk

HSBC has an internal liquidity and funding risk management framework ('LFRF') which aims to allow it to withstand very severe liquidity stresses. It is designed to be adaptable to changing business models, markets and regulations. The management of liquidity and funding is primarily undertaken locally in compliance

with the Group's LFRF, and with practices and limits set by the GMB through the RMM and approved by the Board.

Structure and organisation of the liquidity risk management function

The Group Treasurer, who reports to the Group Finance Director, has responsibility for the oversight of the LFRF. The Asset, Liability and Capital Management ('ALCM') team are responsible for the application of the LFRF within HBEU.

The elements of the LFRF are underpinned by a robust governance framework, the two major elements of which are:

- Asset and liability management committees ('ALCOs'); and
- Annual individual liquidity adequacy assessment process ('ILAAP') used to validate risk tolerance and set risk appetite.

Asset, Liability and Capital Management

Asset, Liability and Capital Management teams provide oversight at both an individual entity and Group level. Regional and local ALCM teams are responsible for the implementation of Group-wide and local regulatory policy at a legal entity level.

Balance Sheet Management

Along with the Group's Global Business Lines, Balance Sheet Management ('BSM') form the first line of defence in the management of liquidity risk, ensuring continuous compliance with the firm's risk appetite operating within their risk mandates.

Second Line of Defence

Liquidity risk assurance is provided by Risk. Second line liquidity risk assurance performs the following activities:

- reviews and challenges assumptions of current liquidity and funding risk management framework;
- reviews and challenges methods and calculation processes of all aspects of liquidity and funding risk;
- reviews results of liquidity and funding metrics against limits and proposed limit changes prior to approval at governance forums; and
- reviews risk items that require escalation.

Hedging and mitigating liquidity risk at HSBC Group

Management of liquidity and funding risk

Liquidity coverage ratio

The Liquidity Coverage Ratio ('LCR') aims to ensure that a bank has sufficient unencumbered high-quality liquid assets ('HQLA') to meet its liquidity needs in a 30 calendar day liquidity stress scenario. For the calculation of the LCR, HSBC follows the guidelines set by the European Commission.

The calculation of the LCR metric, involves an assumption on operational deposits. Operational deposits are principally defined as transactional accounts arising from the provision of custody services by HSBC Security Services or Global Liquidity and Cash Management. To make an assessment of operational deposits both the balance history as well as the values of account debits and credits over a period time are referenced.

Net stable funding ratio

HSBC uses the NSFR as a basis for establishing stable funding within the group. The NSFR requires institutions to maintain sufficient stable funding and reflects a bank's long-term funding profile (funding with a term of more than one year).

Liquid assets

Liquid assets are held and managed on a stand-alone operating entity basis. Most are held directly by each operating entity's BSM department, primarily for the purpose of managing liquidity risk in line with the LFRF.

The liquid asset buffer may also include securities in held-to maturity portfolios. To qualify as part of the liquid asset buffer, held-to-maturity portfolios must have a deep and liquid repo market in the underlying security.

Liquid assets also include any unencumbered liquid assets held outside BSM departments for any other purpose. The LFRF gives ultimate control of all unencumbered assets and sources of liquidity to BSM.

Overall adequacy of liquidity risk management

All operating entities are required to prepare an internal liquidity adequacy assessment ('ILAA') document, to ensure that:

- liquidity resources are adequate, both in amount and quality;
- there is no significant risk that liabilities cannot be met as they fall due;
- a prudent structural funding profile is maintained;
- adequate liquidity resources continue to be maintained; and
- the operating entity's liquidity risk framework is adequate and robust.

The two key objectives of the ILAAP process are to:

1. demonstrate that all material liquidity and funding risks are captured within the internal framework; and
2. validate the operating entity's risk tolerance/appetite by demonstrating that reverse stress testing scenarios are acceptably remote; and vulnerabilities have been assessed through the use of severe stress scenarios.

The final conclusion of the ILAAP, approved by the Board of Directors, is that each operating entity:

- maintains liquidity resources which are adequate in both amount and quality at all times, and ensures that
- there is no significant risk that its liabilities cannot be met as they fall due; and
- ensures its liquidity resources contain an adequate amount of high quality liquid assets ('HQLA') and maintain a prudent funding profile.

Liquidity stress testing

ALCM undertakes liquidity stress testing to test that its risk appetite is correct, to validate that it can continue to operate under various stress scenarios and to test whether the stress assumptions within the LCR scenario are appropriate and conservative enough for the group's business. ALCM also conducts reverse stress testing with the specific aim of reviewing the remoteness of the scenarios that would lead the entity to exhaust its liquidity resources. If the scenarios are not deemed remote enough, then corrective action is taken.

Several different stress testing scenarios are run that test the quality of liquidity resources under stresses of varying durations and nature. As part of this exercise, various assumptions are used which are approved by the relevant ALCO and Board and the results of the stress testing are presented through the ILAAP to the Board and on a quarterly basis to the relevant ALCO.

Liquidity management across the group

The structure of the group means that liquidity and funding risk cannot practically be managed on a consolidated group basis and can only be managed by entity on a stand-alone basis. The group's liquidity and funding risk framework requires all operating entities to manage liquidity and funding risk on a stand-alone basis in accordance with the Group's liquidity and funding risk management framework and the liquidity and funding risk tolerances set out in the Risk Appetite Statement.

The group's internal liquidity and funding risk management framework does not therefore seek to manage liquidity and funding risk on a consolidated basis, other than to ensure that the position of the consolidated group meets the minimum regulatory requirements.

HSBC Group's business strategy and overall liquidity risk profile

The key aspects of the LFRF are:

- stand-alone management of liquidity and funding by operating entity;

- minimum LCR requirement depending on Inherent Liquidity Risk ('ILR') categorisation;
- minimum NSFR requirement depending on ILR categorisation;
- legal entity depositor concentration limit;
- three-month and 12-month cumulative rolling term contractual maturity limits covering deposits from banks, deposits from non-bank financial institutions and securities issued;
- annual individual liquidity adequacy assessment by principal operating entity;
- minimum LCR requirement by currency;
- intra-day liquidity;
- liquidity funds transfer pricing; and
- forward-looking funding assessments.

The internal LFRF and the risk tolerance limits were approved by the RMM and the Board on the basis of recommendations made by the Group Risk Committee.

Structural foreign exchange exposures

Structural foreign exchange exposures represent the group's net investments in subsidiaries, branches and associates, the functional currencies of which are currencies other than sterling. An entity's functional currency is that of the primary economic environment in which the entity operates.

The group's structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that the group's consolidated capital ratios and the capital ratios of individual banking subsidiaries are largely protected from the effect of changes in exchange rates. This is usually achieved by ensuring that, for each subsidiary bank, the ratio of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio of the subsidiary in question.

Details of our structural foreign exchange exposures are provided on page 65 of the HSBC Bank plc Annual Report and Accounts 2018*.*

Reputational risk

Reputational risk is the risk of failing to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by HSBC, our employees or those with whom we are associated. Any material lapse in standards of integrity, compliance, customer service or operating efficiency may represent a potential reputational risk. Stakeholder expectations constantly evolve, and so reputational risk is dynamic and varies between geographical regions, groups and individuals. We have an unwavering commitment to operate at the high standards we set for ourselves in every jurisdiction.

For further details of our reputational risk management, see pages 86 to 87 of the HSBC Holdings plc Annual Report and Accounts 2018*.*

Sustainability risk

Sustainability risk arises from the provision of financial services to companies or projects which indirectly result in unacceptable impacts on people or on the environment. Sustainability risk is:

- measured by assessing the potential sustainability effect of a customer's activities and assigning a Sustainability Risk Rating to all high-risk transactions;
- monitored quarterly by the RMM and monthly by the Group's Sustainability Risk function; and
- managed using sustainability risk policies covering project finance lending and sector-based sustainability policies for sectors and themes with potentially large environmental or social impacts.

For further details on sustainability risk management, see page 87 of the HSBC Holdings plc Annual Report and Accounts 2018*.*

Business risk

The PRA specifies that banks, as part of their ICAAP, should review their exposure to business risk.

Business risk is the potential negative effect on profits and capital from the group not meeting our strategic objectives, as a result of unforeseen changes in the business and regulatory environment, exposure to economic cycles and technological changes.

We manage and mitigate business risk through our risk appetite, business planning and stress testing processes. This ensures that our business model and planned activities are monitored, resourced and capitalised consistent with the commercial, economic and risk environment in which the group operates. Consequently any potential vulnerabilities of our business plans are identified at an early stage so that mitigating actions can be taken.

Dilution risk

Dilution risk is the risk that an amount receivable is reduced through cash or non-cash credit to the obligor, and arises mainly from factoring and invoice discounting transactions.

Where there is recourse to the seller, we treat these transactions as loans secured by the collateral of the debts purchased and do not report dilution risk for them. For our non-recourse portfolio, we obtain an indemnity from the seller that indemnifies us against this risk. Moreover, factoring transactions involve lending at a discount to the face value of the receivables that provides protection against dilution risk.

Remuneration

As a wholly-owned subsidiary, HSBC Bank plc is subject to the remuneration policy established by HSBC. Details of HSBC's remuneration policy, including details on the Remuneration Committee membership and its activities, our remuneration strategy, and remuneration details of HSBC's Identified Staff and Material Risk-Takers ('MRT') is set out in the Remuneration Policy on our website (https://www.hsbc.com/our-approach/corporate-governance/remuneration) and in the Directors' Remuneration Report on pages 172 to 205 of the HSBC Holdings plc *Annual Report and Accounts 2018*.

The following tables show the remuneration awards made to Identified Staff and MRTs in HSBC Bank plc for 2018. Individuals have been identified as MRTs based on the qualitative and quantitative criteria set out in the Regulatory Technical Standard EU 604/2014 which came into force in June 2014 and was subsequently adopted in full for the purposes of the PRA's and the Financial Conduct Authority's ('FCA') Remuneration Code. The tables below include the total remuneration of HSBC Bank plc senior management and other individuals identified as HSBC Bank MRTs based on their role and professional activities. This also includes certain individuals employed by the Group who have broader roles within HSBC, for example those with global roles.

These disclosures reflect the requirements of the FCA's Prudential Sourcebook for Banks.

Table 24: Senior management remuneration – fixed and variable amounts (REM1)

	Executive Directors	Non-executive Directors	Senior management	Total
Number of MRTs	**3**	**7**	**17**	**27**
	£m	**£m**	**£m**	**£m**
Total fixed	**2.6**	**1.3**	**10.5**	**14.4**
Cash-based[1]	**2.6**	**1.3**	**10.5**	**14.4**
– of which: deferred cash	—	—	—	—
Share-based	—	—	—	—
– of which: deferred shares	—	—	—	—
Total variable[2]	**2.5**	—	**10.2**	**12.7**
Cash-based	**1.2**	—	**4.9**	**6.1**
– of which: deferred cash	***0.7***	—	***2.6***	***3.3***
Share-based[3]	**1.3**	—	**5.3**	**6.6**
– of which: deferred shares[3]	***0.8***	—	***3.1***	***3.9***
Other forms	—	—	—	—
– of which: deferred	—	—	—	—
Total remuneration	**5.1**	**1.3**	**20.7**	**27.1**

1 *Cash-based fixed remuneration is paid immediately.*
2 *Variable pay awarded in respect of 2018. In accordance with shareholder approval received on 23 May 2014 (98% in favour), for each MRT the variable component of remuneration for any one year is limited to 200% of fixed component of the total remuneration of the MRT.*
3 *Share-based awards are made in HSBC shares. Vested shares are subject to a retention period of up to one year.*

Table 25: Senior management guaranteed bonus, sign-on and severance payments (REM2)

	Executive Directors	Non-executive Directors	Senior management	Total
Guaranteed bonus and sign-on payments[1]				
Made during year (£m)	—	—	—	—
Number of beneficiaries	—	—	—	—
Severance payments[2]				
Awarded and made during year (£m)	—	—	—	—
Number of beneficiaries	—	—	—	—
Highest such award to a single person (£m)	—	—	—	—
Made during year (£m)	—	—	—	—
Number of beneficiaries	—	—	—	—

1 *No sign-on payments were made in 2018. A guaranteed bonus is awarded in exceptional circumstances for new hires, and in the first year only. The circumstances where HSBC would offer a guaranteed bonus would typically involve a critical new hire and would also depend on factors such as the seniority of the individual, whether the new hire candidate has any competing offers and the timing of the hire during the performance year.*
2 *Includes payments such as payment in lieu of notice, statutory severance, outplacement service, legal fees, ex-gratia payments and settlements (excludes pre-existing benefits triggered on termination).*

Table 26: Senior management deferred remuneration (REM3)[1]

£m	Executive Directors	Non-executive Directors	Senior management	Total
Cash				
Total outstanding deferred remuneration[2]	1.4	—	4.9	6.3
– of which: Unvested	*1.4*	—	*4.9*	*6.3*
– of which: Total amount of outstanding deferred and retained remuneration exposed to ex post explicit and/or implicit adjustment	*1.4*	—	*4.9*	*6.3*
Total amount of amendment during the year due to ex post implicit adjustment	—	—	—	—
Total amount of amendment during the year due to ex post explicit adjustment[3]	—	—	—	—
Total amount of deferred remuneration paid out in the financial year	0.6	—	1.8	2.4
Shares				
Total outstanding deferred remuneration[2]	3.2	—	8.6	11.8
– of which: Unvested	*2.8*	—	*7.7*	*10.5*
– of which: Total amount of outstanding deferred and retained remuneration exposed to ex post explicit and/or implicit adjustment	*3.2*	—	*8.6*	*11.8*
Total amount of amendment during the year due to ex post implicit adjustment	(0.5)	—	(1.4)	(1.9)
Total amount of amendment during the year due to ex post explicit adjustment[3]	—	—	—	—
Total amount of deferred remuneration paid out in the financial year[4]	1.7	—	5.1	6.8
Other forms				
Total outstanding deferred remuneration[2]	—	—	—	—
– of which: Unvested	—	—	—	—
– of which: Total amount of outstanding deferred and retained remuneration exposed to ex post explicit and/or implicit adjustment	—	—	—	—
Total amount of amendment during the year due to ex post implicit adjustment	—	—	—	—
Total amount of amendment during the year due to ex post explicit adjustment[3]	—	—	—	—
Total amount of deferred remuneration paid out in the financial year[4]	—	—	—	—

1 *This table provides details of adjustments during performance year 2018. For details of variable pay awards granted for 2018, please refer to both the remuneration tables above. Deferred remuneration is made in cash and/or shares. Share-based awards are made in HSBC shares.*
2 *Includes unvested deferred awards, and vested awards subject to retention period as at 31 December 2018.*
3 *Includes any amendments due to malus or clawback.*
4 *Shares are considered as paid when they vest. Vested shares are valued using the sale price or the closing share price on the business day immediately preceding the vesting day.*

Table 27: Other MRTs remuneration – fixed and variable amounts (REM1)

	Investment banking	Retail banking	Asset management	Corporate functions	Independent control functions	All other	Total
Number of MRTs	296	28	3	14	57	18	416
	£m	£m	£m	£m	£m	£m	£m
Total fixed	156.5	12.1	1.7	11.5	16.6	12	210.4
Cash-based[1]	156.5	12.1	1.7	10.5	15.6	8.6	205.0
– of which: deferred cash	—	—	—	—	—	—	—
Share-based	—	—	—	1.0	1.0	3.4	5.4
– of which: deferred shares	—	—	—	—	—	—	—
Total variable[2]	157.6	13.3	1.6	11.9	16.7	11.4	212.5
Cash-based	76.5	6.4	0.8	5.3	7.2	3.2	99.4
– of which: deferred cash	*41.3*	*3.4*	*0.3*	*2.9*	*2.6*	*1.0*	*51.5*
Share-based[3]	81.1	6.9	0.3	6.6	9.5	8.2	112.6
– of which: deferred shares[3]	*46.1*	*4.0*	*0.2*	*4.2*	*6.0*	*6.2*	*66.7*
Other forms[3]	—	—	0.5	—	—	—	0.5
– of which: deferred[3]	—	—	*0.5*	—	—	—	*0.5*
Total remuneration	314.1	25.4	3.3	23.4	33.3	23.4	422.9

1 *Cash-based fixed remuneration is paid immediately.*
2 *Variable pay awarded in respect of 2018. In accordance with shareholder approval received on 23 May 2014 (98% in favour), for each MRT the variable component of remuneration for any one year is limited to 200% of the fixed component of the total remuneration of the MRT.*
3 *Share-based awards are made in HSBC shares. Vested shares are subject to a retention period of up to one year.*

Table 28: Other MRTs guaranteed bonus, sign-on and severance payments (REM2)

	Investment banking	Retail banking	Asset management	Corporate functions	Independent control functions	All other	Total
Guaranteed bonus and sign-on payments[1]							
Made during year (£m)	–	–	–	–	0.05	–	0.05
Number of beneficiaries	–	–	–	–	1	–	1
Severance payments[2]							
Awarded and made during year (£m)	12.9	0.1	–	0.3	–	0.7	14
Number of beneficiaries	16	1	–	1	–	2	20
Highest such award to a single person (£m)	4.1	0.1	–	0.3	–	0.6	–
Made during year (£m)	10.1	0.1	–	0.3	–	0.6	11.1
Number of beneficiaries	16	1	–	1	–	1	19

1 *No sign-on payments were made in 2018. A guaranteed bonus is awarded in exceptional circumstances for new hires, and in the first year only. The circumstances where HSBC would offer a guaranteed bonus would typically involve a critical new hire and would also depend on factors such as the seniority of the individual, whether the new hire candidate has any competing offers and the timing of the hire during the performance year.*
2 *Includes payments such as payment in lieu of notice, statutory severance, outplacement service, legal fees, ex-gratia payments and settlements (excludes pre-existing benefits triggered on termination).*

Table 29: Other MRTs deferred remuneration (REM3)[1]

	Investment banking	Retail banking	Asset management	Corporate functions	Independent control functions	All other	Total
£m							
Cash							
Total outstanding deferred remuneration[2]	86.1	5.3	0.7	5.6	4.9	3.2	105.8
– of which: Unvested	*86.1*	*5.3*	*0.7*	*5.6*	*4.9*	*3.2*	*105.8*
Total amount of outstanding deferred and retained remuneration exposed to ex post explicit and/or implicit adjustment	86.1	5.3	0.7	5.6	4.9	3.2	105.8
Total amount of amendment during the year due to ex post implicit adjustment	–	–	–	–	–	–	–
Total amount of amendment during the year due to ex post explicit adjustment[3]	–	–	–	–	–	–	–
Total amount of deferred remuneration paid out in the financial year	35.7	2.2	0.5	2.9	2.2	2.5	46.0
Shares							
Total outstanding deferred remuneration[2]	125.2	9.0	0.8	23.5	20.9	24.2	203.6
– of which: Unvested	*114.2*	*8.2*	*0.8*	*21.8*	*18.8*	*22.7*	*186.5*
Total amount of outstanding deferred and retained remuneration exposed to ex post explicit and/or implicit adjustment	125.2	9.0	0.8	23.5	20.9	24.2	203.6
Total amount of amendment during the year due to ex post implicit adjustment	(19.0)	(1.4)	(0.1)	(3.7)	(3.4)	(4.2)	(31.8)
Total amount of amendment during the year due to ex post explicit adjustment[3]	–	–	–	–	–	–	–
Total amount of deferred remuneration paid out in the financial year[4]	91.9	5.7	0.8	10.0	9.3	9.8	127.5
Other forms							
Total outstanding deferred remuneration[2]	–	–	0.7	–	–	–	0.7
– of which: Unvested	–	–	*0.6*	–	–	–	*0.6*
Total amount of outstanding deferred and retained remuneration exposed to ex post explicit and/or implicit adjustment	–	–	0.7	–	–	–	0.7
Total amount of amendment during the year due to ex post implicit adjustment	–	–	–	–	–	–	–
Total amount of amendment during the year due to ex post explicit adjustment[3]	–	–	–	–	–	–	–
Total amount of deferred remuneration paid out in the financial year	–	–	0.1	–	–	–	0.1

1 *This table provides details of adjustments during performance year 2018. For details of variable pay awards granted for 2018, please refer to both the remuneration tables above. Deferred remuneration is made in cash and/or shares. Share-based awards are made in HSBC shares and/or linked to notional fund units in the HSBC World Selection Balanced Portfolio.*
2 *Includes unvested deferred awards, and vested deferred awards subject to retention period as at 31 December 2018.*
3 *Includes any amendments due to malus or clawback.*
4 *Shares are considered as paid when they vest. Vested shares are valued using the sale price or the closing share price on the business day immediately preceding the vesting day.*

Table 30: Material risk takers' remuneration by band[1]

	Management body	All other	Total
€0 – 1,000,000	8	262	270
€1,000,000 – 1,500,000	—	75	75
€1,500,000 – 2,000,000	1	40	41
€2,000,000 – 2,500,000	—	23	23
€2,500,000 – 3,000,000	—	9	9
€3,000,000 – 3,500,000	1	5	6
€3,500,000 – 4,000,000	—	4	4
€4,000,000 – 4,500,000	—	8	8
€4,500,000 – 5,000,000	—	3	3
€5,000,000 – 6,000,000	—	1	1
€6,000,000 – 7,000,000	—	1	1
€7,000,000 – 8,000,000	—	—	—
€8,000,000 – 9,000,000	—	—	—
€9,000,000 – 10,000,000	—	1	1
€10,000,000 – 11,000,000	—	—	—
€11,000,000 – 12,000,000	—	1	1

1 *Table prepared in euros in accordance with Article 450 of the European Union Capital Requirements Regulation, using the exchange rates published by the European Commission for financial programming and budget for December of the reported year as published on its website.*

Appendix I

Abbreviations

The following abbreviated terms are used throughout this document.

Abbreviation	Term
A	
AFS[1]	Available-for-sale
ALCM	Asset, Liability and Capital Management
ALCO	Asset and Liability Management Committee
AT1 capital	Additional tier 1 capital
B	
BCBS	Basel Committee on Banking Supervision
BoE	Bank of England
BSM	Balance Sheet Management
C	
CCP	Central counterparty
CCR[1]	Counterparty credit risk
CDS[1]	Credit default swap
CET1[1]	Common equity tier 1
CIU	Collective investment undertakings
CMB	Commercial Banking
CRA	Credit risk adjustment
CRD IV[1]	Capital Requirements Regulation and Directive
CRE[1]	Commercial real estate
CRM	Credit risk mitigation/mitigant
CRR[1]	Revisions to the Capital Requirements Regulation and Directive
CVA	Credit valuation adjustment
E	
EAD[1]	Exposure at default
EBA	European Banking Authority
EC	European Commission
ECL	Expected credit losses
EEA	European Economic Area
EL[1]	Expected loss
EU	European Union
EVE	Economic value of equity
F	
FCA	Financial Conduct Authority's
FPC[1]	Financial Policy Committee (UK)
FRTB	Fundamental Review of the Trading book
FSB	Financial Stability Board
G	
GB&M	Global Banking and Markets, a global business
GPB	Global Private Banking, a global business
Group	HSBC Holdings together with its subsidiary undertakings
H	
HMT	Her Majesty's Treasury
HQLA	High-quality liquid assets
HSBC	HSBC Holdings together with its subsidiary undertakings
I	
IAA	Internal Assessment Approach
ICAAP[1]	Internal Capital Adequacy Assessment Process
ICG	Individual capital guidance
IFRSs	International Financial Reporting Standards
ILAA	Individual Liquidity Adequacy Assessment
ILR	Inherent Liquidity Risk
IMA[1]	Internal Models Approach
IMM[1]	Internal Model Method
IRB[1]	Internal ratings based approach
IRC	Incremental risk charge
IRRBB	Interest rate risk in the banking book
L	
LCR	Liquidity Coverage Ratio
LFRF	Liquidity and Funding Risk Management Framework
LGD[1]	Loss given default
M	
MREL	Minimum requirements for own funds and eligible liabilities
MRT	Material Risk-Takers
N	
NQH	Non Qualifying Hedge
NSFR	Net Stable Funding Ratio
O	
OTC[1]	Over-the-counter
P	
PD[1]	Probability of default
PFE	Potential future exposure
PRA[1]	Prudential Regulation Authority (UK)
R	
RAS	Risk appetite statement
RBM[1]	Ratings Based Method
RBWM	Retail Bank and Wealth Management, a global business
RFB	UK ring-fenced bank
RMM	Risk Management Meeting of the GMB
RNIV	Risks not in VaR
RWA[1]	Risk-weighted asset
S	
S&P	Standard and Poor's rating agency
SFM	Supervisory Formula Method
SFT	Securities Financing Transactions
SME	Small- and medium-sized enterprise
SPE[1]	Special Purpose Entity
SREP	Supervisory Review and Evaluation Process
STD[1]	Standardised approach
T	
TLAC[1]	Total Loss Absorbing Capacity
TTC	Through-the-cycle
T1 capital	Tier 1 capital
T2 capital	Tier 2 capital
U	
UK	United Kingdom
V	
VaR[1]	Value at risk

1 *Full definition included in Glossary on the HSBC website www.hsbc.com.*

Appendix II

Cautionary statement regarding forward-looking statements

The *Pillar 3 Disclosures at 31 December 2018* contains certain forward-looking statements with respect to the group's financial condition, results of operations, capital position and business.

Statements that are not historical facts, including statements about the group'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 to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made. HSBC Bank 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 Bank'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 include, but are not limited to:

- changes in general economic conditions in the markets in which we operate, such as continuing or deepening recessions and fluctuations in employment beyond those factored into consensus forecasts; changes in foreign exchange rates and interest rates; volatility in equity markets; lack of liquidity in wholesale funding markets; illiquidity and downward price pressure in national real estate markets; adverse changes in central banks' policies with respect to the provision of liquidity support to financial
- markets; heightened market concerns over sovereign creditworthiness in over-indebted countries; adverse changes in the funding status of public or private defined benefit pensions; and consumer perception as to the continuing availability of credit and price competition in the market segments we serve;
- changes in government policy and regulation, including the monetary, interest rate and other policies of central banks and other regulatory authorities; initiatives to change the size, scope of activities and interconnectedness of financial institutions in connection with the implementation of stricter regulation of financial institutions in key markets worldwide; revised capital and liquidity benchmarks which could serve to deleverage bank balance sheets and lower returns available from the current business model and portfolio mix; imposition of levies or taxes designed to change business mix and risk appetite; the practices, pricing or responsibilities of financial institutions serving their consumer markets; expropriation, nationalisation, confiscation of assets and changes in legislation relating to foreign ownership; changes in bankruptcy legislation in the principal markets in which we operate and the consequences thereof; general changes in government policy that may significantly influence investor decisions; extraordinary government actions as a result of current market turmoil; other unfavourable political or diplomatic developments producing social instability or legal uncertainty which in turn may affect demand for our products and services; the costs, effects and outcomes of product regulatory reviews, actions or litigation, including any additional compliance requirements; and the effects of competition in the markets where we operate including increased competition from non-bank financial services companies, including securities firms; and
- factors specific to HSBC Bank, including discretionary RWA growth and our success in adequately identifying the risks we face, such as the incidence of loan losses or delinquency, and managing those risks (through account management, hedging and other techniques). Effective risk management depends on, among other things, our ability through stress testing and other techniques to prepare for events that cannot be captured by the statistical models it uses; and our success in addressing operational, legal and regulatory, and litigation challenges.

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