HSBC HOLDINGS PLC

SUPPLEMENTARY
REGULATORY DISCLOSURES

30 June 2013

Composition of regulatory capital on CRD IV basis

In October 2012, the PRA wrote to large UK firms describing the disclosures it required them to make for capital resources on a first year transitional basis and for the leverage ratio on an end point basis under CRD IV. At 31 December 2012, our disclosures were based on the July 2011 draft version of the CRD IV text. In July 2013, the PRA provided updated instructions to prepare the 30 June 2013 disclosures based on the final CRD IV rules. The table overleaf presents our estimated composition of regulatory capital calculated on a CRD IV transitional basis in accordance with those PRA instructions and our interpretation of the CRD IV final rules.

Basis of preparation

The disclosure is required in the format prescribed in Annex VI 'Transitional Own Fund disclosure template' of the EBA consultation paper 'Draft Implementing Technical Standards on Disclosure for Own Funds by Institutions' issued on 7 June 2012, but based on the final CRD IV rules published in June 2013.

Where appropriate, additional line items have been included in the table below to accommodate certain amounts not captured by the template. We have also provided additional information in the second column for completeness, to facilitate the reading of the end point capital resources position which results from adding the two columns together.

The CRD IV final rules are to be applied at 30 June 2013, as if 2013 is the first year of the transition period. As at 31 December 2012, the disclosures were based on July 2011 CRD IV draft rules, assuming 2012 was the first year of transition.

The table has been prepared in line with PRA's instructions and using the supplementary guidance: 'CRD IV transitional provisions on capital resources' published by the PRA. This states that where the CRD IV provides for a range of transitional percentages on calculating regulatory capital, banks should use the minimum phase-in percentages, with the exception of the following items: deferred tax assets not arising from timing differences (10% of the total amount to be deducted from CET1), investment in own shares (100% deducted from CET1), and interim losses (100% deducted from CET1).

Under the final CRD IV text, the transitional percentages that apply to regulatory adjustments and deductions generally start at 20% in the first year of the transition period. The residual amounts of transitional items would receive the capital treatment prescribed under the transitional rules which, with a few exceptions, do not allow for current national treatments to continue to be applied. Inclusion of grandfathered capital instruments is limited to 80% of their regulatory nominal value calculated at 31 December 2012.

We have included US$8.7bn of Tier 2 capital instruments as CRD IV eligible capital, on both end point and transitional basis, based on their compliance with the final CRD IV rules which do not require these instruments to contain a contractual write-down/conversion clause at the point of non-viability.

Additionally, for other national discretions that could have a material impact on the capital resources, the PRA has required the treatment that leads to the lowest ratio. At 30 June 2013 this resulted in the derecognition in full of unrealised gains on exposures to central governments classified as available-for-sale of US$1.5bn.

The PRA are consulting on the UK implementation of CRD IV and this includes various national discretions. In addition, numerous Regulatory Technical Standards ('RTS') and Implementing Technical Standards ('ITS') have been issued by the EBA in draft form for consultation, and others are pending publication. This gives rise to further uncertainty regarding the precise capital impact of CRD IV as the effect of these draft standards are not captured in our numbers and could result in significant changes to our estimates.

In applying the CRD IV final rules, we have changed the treatment of non-consolidated insurance entities. This removed from our Group consolidated reserves the post-acquisition reserves, and calculated the amount of the insurance holdings deduction at cost.

Future planned management actions to mitigate the effect of capital deductions for non-significant (or 'immaterial') holdings of financial sector entities have been taken into account as at 30 June 2013.

These management actions would eliminate the deduction for non-significant holdings in financial sector entities of US$3.9bn (2012: US$6bn) – on a full impact basis – and hence there is no deduction shown in the table on a transitional basis. The effect of this would also increase the 10% and 15% thresholds for the items included in the ‘deductions under threshold approach’.

The extent of permissible netting of holdings in financial sector entities remains subject to clarification by regulators and may decrease the amount of management actions necessary. If additional netting were to be recognised in full, the residual management action could be reduced from US$3.9bn to US$0.4bn, on a full impact basis.

Although CRD IV final rules have now been published, there remains substantial regulatory uncertainty around the application of the rules for deductions of holdings in the capital of financial sector entities. The EBA recently launched a consultation on the draft ‘Regulatory Technical Standards (RTS) for Own Funds – Part III’, which introduces fundamentally new concepts in this area and has the potential to significantly increase the level of the capital deduction. This RTS is still in draft. We have responded to the consultation and are engaging in dialogue with regulators regarding its proposals. Dependent upon the final standard, we will further consider what, if any, management actions will be possible to mitigate the effect of CRD IV as it may not be possible to mitigate the impact in full.

In March 2013, the Financial Policy Committee (‘FPC’) directed the PRA to ensure major UK banks hold capital resources equivalent to at least 7% of their risk-weighted assets, by December 2013, using a Basel III definition of CET1 but after taking deductions to reflect the FPC’s assessment of expected future losses, future costs of conduct redress and adjusting for a more prudent calculation of risk weights.

Subsequently the PRA has defined a forward-looking CET1 target for the Group.

Important elements of the new capital framework are yet to be clarified. There remains continued uncertainty around the precise amount of capital that banks will be required to hold. These include the quantification and interaction of capital buffers and additional regulatory adjustments. Furthermore, there are a significant number of national discretions within the legislation, which the UK has yet to implement, and a number of unpublished EBA technical and implementation standards.

We currently manage our capital position to meet an internal target CET1 ratio of greater than 10% on a Basel III end point basis and continue to keep this under review.

Our approach to managing Group capital is designed to ensure that we exceed current, and are well placed to meet expected future, regulatory requirements.

Composition of regulatory capital on a CRD IV basis

	At 30 June 2013 US$bn	Amounts subject to pre-CRR treatment or CRR prescribed residual amount US$bn
Common equity tier 1 ('CET1') capital: instruments and reserves		
Capital instruments and the related share premium accounts	19.0	
Retained earnings	121.7	
Accumulated other comprehensive income (and other reserves)	16.4	
Minority interests (amount allowed in consolidated CET1)	4.5	(1.0)
Independently reviewed interim net profits net of any foreseeable charge or dividend	2.7	
Common equity tier 1 capital before regulatory adjustments	164.3	(1.0)
Common equity tier 1 capital: regulatory adjustments	(9.4)	(27.0)
Additional value adjustments	(1.3)	(1.1)
Intangible assets (net of related deferred tax liability)	(4.9)	(19.8)
Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	–	(0.4)
Fair value reserves related to gains or losses on cash flow hedges	0.2	–
Negative amounts resulting from the calculation of expected loss amounts	(1.3)	(5.2)
Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	–	(0.5)
Defined-benefit pension fund assets	(1.3)	–
Direct and indirect holdings of own CET1 instruments	(0.8)	–
Regulatory adjustments applied to common equity tier 1 in respect of amounts subject to pre-CRR treatment		
Regulatory adjustments relating to unrealised gains and losses	(1.0)	(0.5)
of which: unrealised gains on available-for-sale debt instruments	1.6	(3.1)
of which: unrealised gains on available-for-sale equity instruments	(1.3)	1.3
of which: reserves arising from revaluation of property	(1.3)	1.3
Amounts to be deducted from or added to common equity tier 1 capital with regard to additional filters and deductions required pre-CRR	1.0	(1.0)
of which: defined benefit pension fund	1.0	(1.0)
Qualifying additional tier 1 deductions that exceed the AT1 capital	(8.5)	8.5
Total regulatory adjustments to common equity tier 1	(17.9)	(20.0)
Common equity tier 1 ('CET1') capital	146.4	(21.0)
Additional tier 1 capital ('AT1'): instruments		
Amount of qualifying items and the related share premium accounts subject to phase out from AT1	10.6	(10.6)
Qualifying tier 1 capital included in consolidated AT1 capital issued by subsidiaries and held by third parties	3.3	(2.9)
of which: instruments issued by subsidiaries subject to phase out	3.2	(3.2)
Additional tier 1 capital before regulatory adjustments	13.9	(13.5)
Additional tier 1 capital: regulatory adjustments		
Regulatory adjustments applied to additional tier 1 capital in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase-out		
Residual amounts deducted from additional tier 1 capital with regard to deduction from common equity tier 1 capital during the transitional period	(22.4)	22.4
Intangible assets (net of deferred tax liability)	(19.8)	19.8
Negative amounts resulting from the calculation of expected loss amounts	(2.6)	2.6
Qualifying additional tier 1 deductions that exceed the AT1 capital	8.5	(8.5)
Total regulatory adjustments to additional tier 1 capital	(13.9)	13.9
Additional tier 1 ('AT1') capital	–	0.4
Tier 1 capital (T1 = CET1 + AT1)	146.4	(20.6)

	At 30 June 2013 US$bn	Amounts subject to pre-CRR treatment or CRR prescribed residual amount US$bn
Tier 2 capital: instruments and provisions		
Capital instruments and the related share premium accounts	**8.7**	**-**
Amount of qualifying items and the related share premium accounts subject to phase out from tier 2	**7.6**	**(7.6)**
Qualifying own funds instruments included in consolidated tier 2 capital issued by subsidiaries and held by third parties	**16.5**	**(16.1)**
of which: instruments issued by subsidiaries subject to phase out	**16.4**	**(16.4)**
Credit risk adjustments	**2.8**	**–**
Tier 2 capital before regulatory adjustments	**35.6**	**(23.7)**
Tier 2 capital: regulatory adjustments		
Regulatory adjustments applied to tier 2 capital in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase-out		
Residual amounts deducted from tier 2 capital with regard to deduction from common equity tier 1 capital during the transitional period	**(2.6)**	**2.6**
Negative amounts resulting from the calculation of expected loss amounts	**(2.6)**	**2.6**
Amount to be deducted from or added to tier 2 capital with regard to additional filters and deductions required pre-CRR	**2.0**	**(2.0)**
of which: unrealised gains on available-for-sale equity instruments	**1.0**	**(1.0)**
of which: reserves arising from revaluation of property	**1.0**	**(1.0)**
Total regulatory adjustments to tier 2 capital	**(0.6)**	**0.6**
Tier 2 (‘T2’) capital	**35.0**	**(23.1)**
Total capital (T1 + T2)	**181.4**	**(43.7)**

Leverage ratio

In October 2012, the PRA wrote to large UK firms describing the disclosures it required them to make for the leverage ratio on an end point basis using a hybrid of Basel III and CRD IV. In July 2013, the PRA provided updated instructions to prepare the 30 June 2013 disclosures. The table below presents our estimated leverage ratio, based on the approach prescribed by the PRA.

Estimated leverage ratio

	At 30 Jun 2013 US$bn
Tier 1 capital under CRD IV (end point)	**125.8**
Exposures after regulatory adjustments	**3,067.4**
Estimated leverage ratio (end point)	**4.1%**

The above excludes those tier 1 capital instruments which will be ineligible for inclusion in regulatory capital after the Basel III transitional period has fully elapsed. If we were to calculate the leverage ratio by adding back those instruments, the effect would be to increase estimated end point tier 1 capital by US$15.8bn and the leverage ratio by some 50 basis points at 30 June 2013.

Basis of preparation

The estimated tier 1 capital figure is based on an ‘end point Basel III’ definition of tier 1 capital applicable from 1 January 2022, applying the final CRD IV rules published in June 2013.

The total exposures are calculated according to the Basel III rules text, the instructions for the Basel III July 2012 Quantitative Impact Study, its related Frequently Asked Questions and the PRA’s guidance on the methodologies used there. They are based on financial accounting rules for on- and off-balance exposures, adjusted as follows:

- the scope of netting for derivatives and Securities Financing Transactions (‘SFT’) is extended to all scenarios where we would recognise a netting agreement for Basel II regulatory purposes, except for cross-product netting which is not permitted. For SFT, only cash payables and receivables are netted and not securities provided or received;
- inclusion of Potential Future Exposure add-ons for both OTC and exchange-traded derivatives;
- off-balance sheet items included in full, except for commitments that are unconditionally cancellable at any time by HSBC without prior notice, where only 10% of the exposures are included;
- exclusion of items deducted from the calculation of end-point tier 1 capital; and
- for investments in banking associates that are equity accounted in the financial accounting consolidation but proportionally consolidated for regulatory purposes, the accounting treatment is used.

We have calculated our Tier 1 capital in accordance with the basis of preparation outlined on page 1.

It should be noted that this PRA prescribed basis for disclosing the leverage ratio is not at this time aligned with either the CRD IV final rules or with the July 2013 proposals on which the Basel Committee is consulting.