HSBC France

Capital and Risk Management Pillar 3 Disclosures at 31 December 2017

HSBC

Contents

	Page
Introduction	
Regulatory framework for disclosures	3
Pillar 3 disclosures	3
Regulatory developments	4
Linkage to the Annual Report and Accounts 2017	4
Capital and Leverage	
Capital management	6
Overview of regulatory capital framework	6
Leverage ratio	8
Capital buffers	8
Pillar 1	9
Pillar 2 and ICAAP	10
Credit risk	
Overview	10
Risk mitigation	18
Counterparty Credit Risk	20
Market risk	21
Operational risk	21
Other risks	22
Interest rate risk in the banking book	22
Risk management of insurance operations	22
Liquidity and funding risk	22
Structural foreign exchange exposures	24
Reputational risk	24
Sustainability risk	24
Business risk	24
Remuneration	24

Appendices

		Page
I	Summary of disclosures withheld due to their immateriality, confidentiality or proprietary nature	27
II	Abbreviations	28
III	Cautionary statement regarding forward-looking statements	29

The abbreviations '€m' and '€bn' represent millions and billions (thousands of millions) of Euros, respectively.

Tables

		Page
1	Pillar 1 Overview	3
2	RWAs by global business	3
3	Reconciliation of balance sheets – financial accounting to regulatory scope of consolidation	5
4	Own funds disclosure	7
5	Summary reconciliation of accounting assets and leverage ratio exposures	8
6	Leverage ratio common disclosure	8
7	Credit risk exposure – summary	11
8	Credit risk exposure – by region	12
9	Credit risk exposure – by industry sector	13
10	Credit risk exposure – by maturity	14
11	Wholesale IRB exposures under the slotting approach	15
12	Amount of impaired exposures and related allowances by industry sector and geographical region	15
13	Movement in specific credit risk adjustments by industry sector and by geographical region	16
14	IRB expected loss and CRA – by exposure class	17
15	IRB exposure – credit risk mitigation	19
16	Standardised exposure – credit risk mitigation	19
17	Counterparty credit risk – RWAs by exposure class and product	20
18	Market risk RWAs and capital required	21
19	Operational risk RWAs and capital required	21
20	Aggregate remuneration expenditure	25
21	Remuneration – fixed and variable amounts	25
22	Deferred remuneration	25
23	Sign-on and severance payments	25
24	Material risk-takers (MRT) remuneration by band	26

Introduction

Table 1: Pillar 1 Overview

	Footnote	RWAs 2017 €m	RWAs 2016 €m	Capital required[1] 2017 €m	Capital required[1] 2016 €m
Credit risk[4]	2	**22,446**	20,865	**1,796**	1,669
Counterparty credit risk		**3,036**	3,707	**243**	297
Market risk		**5,188**	7,907	**415**	633
Operational risk		**3,385**	3,537	**271**	283
Basel 1 floor impact		**1,324**	–	**106**	–
At 31 Dec		**35,379**	36,016	**2,831**	2,882

Table 2: RWAs by global business[3]

	RWAs 2017 €m	RWAs 2016 €m	Capital required[1] 2017 €m	Capital required[1] 2016 €m
Retail Banking and Wealth Management ('RBWM')	**4,615**	4,905	**369**	392
Commercial Banking ('CMB')	**11,133**	10,383	**891**	831
Global Banking and Markets ('GB&M')	**16,713**	19,098	**1,337**	1,529
Global Private Banking ('GPB')	**985**	830	**79**	66
Corporate Centre	**609**	800	**49**	64
Basel 1 floor impact	**1,324**	0	**106**	0
At 31 Dec	**35,379**	36,016	**2,831**	2,882

1 *'Capital required', here and in all tables where the term is used, represents the Pillar 1 capital charge at 8 per cent of RWAs.*
2 *'Credit Risk', here and in all tables where the term is used, excludes counterparty credit risk.*
3 *Please refer to pages 3 and 4 of the HSBC France* Annual Report and Accounts 2017 *for a description of the activities of our global businesses.*
4 *Risk-weighted-assets for default funds had been reported under non-counterparty credit risk in the* Annual Report and Accounts 2016 *and are now reported under the counterparty credit risk section.*

Regulatory framework for disclosures

HSBC France is regulated on a consolidated basis by ECB which sets and monitors local capital adequacy requirements.

At the consolidated HSBC France level, we calculated capital for prudential regulatory reporting purposes throughout 2017 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.

The Basel Committee's framework is structured around three 'pillars': the Pillar 1 minimum capital requirements and Pillar 2 supervisory review process are complemented by Pillar 3 market discipline. The aim of Pillar 3 is to produce disclosures 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.

HSBC France is not subject to Pillar 3 disclosures but has however decided to disclose such information to enhance financial information.

Pillar 3 disclosures

The HSBC France Pillar 3 Disclosures 2017 were prepared along the lines of CRD IV provisions.

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 *Pillar 3 2017 Disclosures* and are also available on page 122 of the HSBC France *Annual Reports and Accounts 2017*. Where disclosures have been enhanced or are new, we do not generally restate or provide prior year comparatives. The own funds disclosure in Table 4 tracks the position from a CRD IV transitional to an end-point basis.

Information relating to the rationale for withholding certain disclosures is provided in Appendix I.

This is the first Pillar 3 disclosure for France available on the HSBC website, www.hsbc.com or www.hsbc.fr, simultaneously with the release of our HSBC France *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 2017* or other location.

Regulatory developments

Basel Committee

After several years of negotiations, an agreement was finally reached last December within the Basel Committee on a Basel III post-crisis package. This agreement, which will have to be transposed into European law, will be applicable from 2022 onwards, with a gradual phase-in until 2027. Its most salient features include a revised standardised approach for credit risk, a further curtailing on the use of internally modelled approaches for credit risk, a revised framework for potential mark-to-market losses on derivative instruments, a new standardised operational risk framework, a higher leverage ratio for global systemically important banks and a general output floor which caps the benefit of internal models.

Moreover, the expected revision of the assessment of market risks, known as fundamental review of the trading book ('FRTB'), should only be agreed in the course of 2018. As a consequence, its implementation has been postponed from 2019 to 2022.

European Union

In the EU, negotiations are still ongoing on the finalization of the so-called CRR2 package which actually includes amendments to different directives and regulations on prudential and resolution matters. Pending issues relate in particular to the calibration of bail-in requirements as well as the new binding leverage ratio, the possible introduction of some elements of the recent Basel agreement, applicable capital charges for certain asset classes (green investments, etc.) and the requirement to set up in the medium term an intermediate parent undertaking for globally systemically important banks that are seated outside the EU.

Besides, the European Commission has put forward in November 2017 a revised approach on the third pillar of the Banking Union, ie. a unified European deposits insurance scheme ('EDIS'), whereby the gradual reinsurance of national deposit schemes would be limited to liquidity (and not losses).

Furthermore, the European Commission has also suggested last November to set up a backstop to the Single Resolution Fund ('SRF') that would be provided by the European Stability Mechanism (or, if created, a future European Monetary Fund) and then reimbursed by the banking industry.

Finally, as far as Non-Performing Loans ('NPL') are concerned, the European Commission launched in last November a consultation on possible statutory prudential backstops in order to address new loans that become non performing.

Linkage to the Annual Report and Accounts 2017

Basis of consolidation

The basis of consolidation for the purpose of financial accounting under IFRSs, described in Note 1 of the Financial Statements, differs from that used for regulatory purposes.

The following table provides a reconciliation of the financial accounting balance sheet to the regulatory scope of consolidation. 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).

Table 3: Reconciliation of balance sheets - financial accounting to regulatory scope of reconciliation

	Accounting balance sheet	De-consolidation of insurance/ other entities	Consolidation of banking associates	Regulatory balance sheet
	€m	€m	€m	€m
Assets				
Cash and balances at central banks	**14,630**	**–**	**–**	**14,630**
Items in the course of collection from other banks	**435**	**–**	**–**	**435**
Trading assets	**22,401**	**(4)**	**–**	**22,397**
Financial assets designated at fair value	**8,605**	**(8,551)**	**–**	**54**
Derivatives	**34,407**	**(90)**	**–**	**34,317**
Loans and advances to banks	**4,843**	**(119)**	**–**	**4,724**
Loans and advances to customers	**44,856**	**–**	**–**	**44,856**
– *of which:*				
impairment allowances on IRB portfolios	***(517)***	**–**	**–**	***(517)***
impairment allowances on standardised portfolios	***(14)***	**–**	**–**	***(14)***
Reverse repurchase agreements – non-trading	**13,781**	**–**	**–**	**13,781**
Financial investments	**20,548**	**(13,217)**	**–**	**7,331**
Assets held for sale	**–**	**–**	**–**	**–**
Capital invested in insurance and other entities	**–**	**–**	**–**	**–**
Current tax assets	**130**	**(39)**	**–**	**91**
Prepayments, accrued income and other assets	**1,915**	**(252)**	**–**	**1,663**
– *of which: retirement benefit assets*				**–**
Interests in associates and joint ventures	**2**	**–**	**–**	**2**
– *of which: positive goodwill on acquisition*	**–**	**–**	**–**	**–**
Goodwill and intangible assets	**766**	**(457)**	**–**	**309**
Deferred tax assets	**225**	**–**	**–**	**225**
Total assets at 31 Dec 2017	**167,544**	**(22,729)**	**–**	**144,815**
Liabilities and equity				
Deposits by banks	**13,297**	**(49)**	**–**	**13,248**
Customer accounts	**38,277**	**–**	**–**	**38,277**
Repurchase agreements – non-trading	**6,586**	**–**	**–**	**6,586**
Items in the course of transmission to other banks	**490**	**–**	**–**	**490**
Trading liabilities	**32,436**	**703**	**–**	**33,139**
Financial liabilities designated at fair value	**7,565**	**(7)**	**–**	**7,558**
Derivatives	**33,229**	**18**	**–**	**33,247**
Debt securities in issue	**5,159**	**–**	**–**	**5,159**
Current tax liabilities	**29**	**(43)**	**–**	**(14)**
Liabilities under insurance contracts	**21,853**	**(21,853)**	**–**	**–**
Accruals, deferred income and other liabilities	**2,086**	**(850)**	**–**	**1,236**
– *of which: retirement benefit liabilities*	***169***	***(2)***	**–**	***167***
Provisions	**103**	**(1)**	**–**	**102**
– *of which:*				
credit-related provisions on IRB portfolios	***7***	**–**	**–**	***7***
credit-related provisions on standardised portfolios	**–**	**–**	**–**	**–**
Deferred tax liabilities	**152**	**(145)**	**–**	**7**
Subordinated liabilities	**576**	**–**	**–**	**576**
– *of which:*				
preferred securities included in tier 1 capital			**–**	**–**
perpetual subordinated debt included in tier 2 capital	***16***	**–**	**–**	***16***
term subordinated debt included in tier 2 capital	***560***	**–**	**–**	***560***
Total liabilities at 31 Dec 2017	**161,838**	**(22,227)**	**–**	**139,611**
Called up share capital	**337**	**–**	**–**	**337**
Share premium account	**16**	**–**	**–**	**16**
Other equity instruments	**200**	**–**	**–**	**200**
Other reserves	**1,600**	**(32)**	**–**	**1,568**
Retained earnings	**3,523**	**(470)**	**–**	**3,053**
Total shareholders' equity	**5,676**	**(502)**	**–**	**5,174**
Non-controlling interests	**30**	**–**	**–**	**30**
– *of which: non-cumulative preference shares issued by subsidiaries included in tier 1 capital*	**–**	**–**	**–**	**–**
Total equity at 31 Dec 2017	**5,706**	**(502)**	**–**	**5,204**
Total liabilities and equity at 31 Dec 2017	**167,544**	**(22,729)**	**–**	**144,815**

Capital and Leverage

Capital management

Approach and policy

HSBC France's objective in managing the bank's capital is to maintain appropriate levels of capital to support its business strategy and meet regulatory and stress testing related requirements.

HSBC France manages its capital to ensure that it exceeds current and expected future requirements. Throughout 2017, HSBC France complied with the European Central Bank ('ECB') regulatory capital adequacy requirements. To achieve this, the bank manages its capital within the context of an annual capital plan which is approved by the Board and which determines the appropriate amount and mix of capital.

In May 2017, HSBC France has performed intragroup Additional Tier 1 and Tier 2 instruments issuances, respectively for EUR 200 million and EUR 300 million. HSBC Bank plc is the counterparty of these instruments. Alongside, HSBC France has released an exceptional dividend of EUR 300 million to HSBC Bank plc. These operations have strengthened HSBC France's total capital base and adjusted its structure to its business strategy and applicable requirements.

HSBC France's capital management policy is underpinned by the capital management framework, which is embedded within Regional and Group's processes, and within the Bank's Annual Operation Plan, as validated by the Board of Directors. This framework enables HSBC France to manage its capital in a consistent manner.

The Internal Capital Adequacy Assessment Process ('ICAAP') that aims at assessing the adequacy of the bank's capital resources in regards of its risk and requirements, incorporates different assessment method of the requirements related to the management and allocation of capital within HSBC France. These capital measures include invested capital, economic capital and regulatory capital defined as follows:

- Invested capital is the equity capital provided to the bank by HSBC Bank plc;
- Economic capital is the internally calculated capital requirement which is deemed necessary by HSBC France to support the risks to which it is exposed; and
- Regulatory capital is the level of capital which HSBC France is required to hold in accordance with the rules set by the ECB for the bank.

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

Stress testing

Stress testing is incorporated in the capital management framework and is an important component of understanding the sensitivities of the core assumptions included in HSBC France'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 also been used to inform the capital planning process and further develop the stress scenarios employed within HSBC France.

Regulatory stress tests and sensitivity analyses are also carried out at the request of regulators using their prescribed assumptions. HSBC France takes into account the results of all such regulatory and internal stress testing when assessing internal capital requirements.

Risks to capital

Beyond the stress testing framework, a list of the main risks with the related potential impacts on HSBC France's capital ratios is regularly reviewed. These risks are identified as possibly affecting Risk-Weighted Assets ('RWAs') and/or capital position. They can either result from expected regulatory changes, or from structural and activity related items. These risks are monitored regularly within the Asset & Liability Committee and the Risk Committee. For the relevant categories of risk, scenario analyses are performed. The downside or upside scenarios are assessed against our capital management objectives and mitigating actions are assigned as necessary.

HSBC France's approach to managing its capital position has been to ensure the bank complies with current regulatory requirements and internal limits, as well as to ensure that future regulatory requirements are considered for capital planning purposes.

Risk-weighted asset targets

RWA targets for the global businesses are established in accordance with the Group's strategic direction and risk appetite, and approved through HSBC France's processes, and through the Bank's annual planning process.

A monitoring is performed at an operational level taking into account growth strategies; active portfolio management; business and/or customer-level reviews; RWA accuracy and allocation initiatives and risk mitigation.

Business performance against RWA targets is monitored through regular reporting discussed in Asset & Liability Committee, Risk Management Meeting, Executive Committee, Risk Committee and Board of Directors.

Capital generation

HSBC Bank plc is the sole provider of equity capital, and regulatory capital eligible subordinated debt to HSBC France and also provides non-equity capital where necessary. Capital generated in excess of planned requirements is returned to HSBC Bank plc in the form of dividends.

Overview of regulatory capital framework

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

For regulatory purposes, HSBC France'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.

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')

Common Equity Tier 1 ('CET 1') capital is the highest quality form of capital, comprising shareholders' equity and related non-controlling interests (subject to limits). Under CRD IV/CRR various capital deductions and regulatory adjustments are made against these items - these include deductions for goodwill and intangible assets, deferred tax assets that rely on future profitability, negative amounts resulting from the calculation of expected loss amounts under IRB, Holdings of Common Equity Tier 1 securities of financial sector entities are deducted from additional Tier 1 capital, up to the amount that exceeds a regulatory-defined threshold.

Additional Tier 1 capital ('AT1')

Additional Tier 1 capital comprises eligible non-common equity capital securities such as Additional Tier 1 eligible subordinated debt as per CRR, and any related share premium. Holdings of additional Tier 1 securities of financial sector entities are deducted from additional Tier 1 capital.

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 in whole in the event the bank's Common Equity Tier 1 ratio falls below 5.125 per cent.

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 subordinated securities or dated securities on which there is an obligation to pay coupons.

These instruments or subordinated loans comprise dated loan capital repayable at par on maturity and must have 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 ECB. 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.

Table 4: Own funds disclosure

Ref*		At 31 Dec 2017 €m
	Common equity tier 1 ('CET1') capital: instruments and reserves	
1	Capital instruments and the related share premium accounts	353
	– ordinary shares	16
2	Retained earnings	3,500
3	Accumulated other comprehensive income (and other reserves)	1,483
5	Transitional adjustments due to additional minority interests	7
5a	Independently reviewed interim net profits net of any foreseeable charge or dividend	60
6	**Common equity tier 1 capital before regulatory adjustments**	5,403
	Common equity tier 1 capital: regulatory adjustments	–
7	Additional value adjustments	51
8	Intangible assets (net of related deferred tax liability)	(308)
11	Fair value reserves related to gains or losses on cash flow hedges	70
12	Negative amounts resulting from the calculation of expected loss amounts	(98)
14	Gains or losses on liabilities at fair value resulting from changes in own credit standing	113
19	CET1 instruments of financial sector entities where the institution has a significant investment	(528)
22	Amount exceeding the 15% threshold	(59)
28	**Total regulatory adjustments to common equity tier 1**	(759)
29	**Common equity tier 1 capital**	4,644
	Additional tier 1 ('AT1') capital: instruments	–
30	Capital instruments and the related share premium accounts	200
36	**Additional tier 1 capital before regulatory adjustments**	200
	Additional tier 1 capital: regulatory adjustments	–
41b	Residual amounts deducted from AT1 capital with regard to deduction from tier 2 ('T2') capital during the transitional period	(53)
43	**Total regulatory adjustments to additional tier 1 capital**	(53)
44	**Additional tier 1 capital**	147
45	**Tier 1 capital (T1 = CET1 + AT1)**	4,791
	Tier 2 capital: instruments and provisions	–
46	Capital instruments and the related share premium accounts	576
51	**Tier 2 capital before regulatory adjustments**	576
	Tier 2 capital: regulatory adjustments	–
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)	(367)
57	**Total regulatory adjustments to tier 2 capital**	(367)
58	**Tier 2 capital**	209
59	**Total capital (TC = T1 + T2)**	5,000
60	**Total risk-weighted assets**	35,379
	Capital ratios and buffers	–
61	Common equity tier 1	13.1%
62	Tier 1	13.5%
63	Total capital	14.1%
64	Institution specific buffer requirement	1.3%
65	– capital conservation buffer requirement	1.3%
68	Common equity tier 1 available to meet buffers[1]	5.8%
	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)	8
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)	1,036
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability)	225

* *The references identify the lines prescribed in the EBA template that are applicable and where there is a value.*
1 *Common equity tier 1 available to meet buffers after Pillar 1 capital requirements.*

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. The Basel III leverage ratio is a volume-based measure calculated as Tier 1 capital divided by total on- and weighted off-balance sheet exposures, and further netting possibilities on market instruments. 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.

Although there is currently no binding leverage ratio requirement on the Bank, the risk of excess leverage is managed as part of HSBC's global risk appetite framework and monitored using a leverage ratio metric within the Risk Appetite Statement ('RAS'). The RAS articulates the aggregate level and types of risk that HSBC France 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 HSBC France, the leverage exposure measure is also calculated and presented to the Asset & Liability Management Committee every month. The leverage ratio, calculated on a 'transitional basis' under CRD IV was 3.7 per cent at 31 December 2017, down from 4.0 per cent at 31 December 2016. The decrease in leverage ratio during the year was driven by the balance sheet growth and partly offset by capital generation through retained earnings.

Table 5: Summary reconciliation of accounting assets and leverage ratio exposures

Ref*		At 31 Dec 2017 €m	At 31 Dec 2016 €m
1	Total assets as per published financial statements	**167,544**	169,423
	Adjustments for:		
2	– entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	**(22,729)**	(23,485)
4	– derivative financial instruments	**(27,578)**	(41,504)
5	– securities financing transactions ('SFT')	**(1,695)**	(1,849)
6	– off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	**15,424**	14,594
EU-6a	– intragroup exposures excluded from the leverage ratio exposure measure)		
7	– other adjustments	**(386)**	1,042
8	**Total leverage ratio exposure**	**130,580**	118,221

Table 6: Leverage ratio common disclosure

Ref*		At 31 Dec 2017 €m	At 31 Dec 2016 €m
	On-balance sheet exposures (excluding derivatives and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**97,001**	88,763
2	(Asset amounts deducted in determining Tier 1 capital)	**(759)**	(1,227)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)**	**96,242**	87,536
	Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	**1,469**	3,399
5	Add-on amounts for potential future exposure ('PFE') associated with all derivatives transactions (mark-to-market method)	**9,908**	8,806
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to IFRSs		
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(4,643)**	(6,273)
8	(Exempted central counterparty ('CCP') leg of client-cleared trade exposures)		
9	Adjusted effective notional amount of written credit derivatives	**94**	44
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)		
11	**Total derivative exposures**	**6,828**	5,976
	Securities financing transaction exposures		
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	**13,781**	11,963
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	**(1,925)**	(2,091)
14	Counterparty credit risk exposure for SFT assets	**230**	242
16	**Total securities financing transaction exposures**	**12,086**	10,114
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	**15,424**	14,594
18	(Adjustments for conversion to credit equivalent amounts)		
19	**Total off-balance sheet exposures**	**15,424**	14,594
	Exempted exposures		
	Capital and total exposures		
20	**Tier 1 capital**	**4,791**	4,739
21	**Total leverage ratio exposure**	**130,580**	118,221
22	**Leverage ratio**	**3.7%**	4.0%
EU-23	Choice on transitional arrangements for the definition of the capital measure	**Transitional**	Transitional

* *The references identify the lines prescribed in the EBA template, when applicable..*

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 requirements for credit risk, market risk and operational risk. Credit risk includes counterparty and non-counterparty credit risk and securitisation requirements. These requirements are expressed in terms of RWAs.

Risk category	Scope of permissible approaches	Approach adopted by HSBC France
Credit risk	CRR allows three approaches for the calculation of Pillar 1 credit risk capital requirements. The standardised approach requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties. Other counterparties are classified into broad categories and standardised risk weightings are applied to these categories. The internal ratings-based ('IRB') foundation approach, allows banks to calculate their credit risk capital requirements on the basis of their internal assessment of a counterparty's probability of default ('PD'), while their estimates of exposure at default ('EAD') and loss given default ('LGD') are subject 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. Expected Losses are assessed by multiplying EAD by PD and LGD. The capital requirement is intended to cover unexpected losses. It is based on a formula foreseen by the regulatory framework which incorporates PD, LGD, EAD and other variables such as maturity and correlation.	In order to assess its credit risk, HSBC France use IRB advanced approach on sovereign, institutions, and retail customers' risks since 2007 year-end, following ACPR approval. HSBC France has also been granted ACPR approval for the use of IRBA advanced approach on commercial customers (LGD in 2009, EAD in 2012). Only few residual expositions are currently still assessed based on IRB foundation or standardised approaches.
Counterparty credit risk	Three approaches to calculating CCR and determining exposures are defined by the CRR: mark-to-market, standardised and Internal Model Method ('IMM'). These exposures are used to determine capital requirements under one of the credit risk approaches; standardised, IRB foundation and IRB advanced. Two approaches are set out by the Regulatory Authorities for calculating the Credit Valuation Adjustment ('CVA') risk capital charge: an advanced methodology that is only available to institutions that have approved internal models, and a standardised approach.	In order to determine exposures at default, HSBC France applies the mark-to-market evaluation method for derivatives and the financial security – based method for deferred payment transactions. HSBC France currently uses the latest that determines the CVA risk charge according to a prescribed formula which is based on the exposure at default of the counterparty credit risk and the effective maturity of the transaction. Risk weights are applied in the calculation and are based on the external credit rating of the counterparty.
Equity	For non-trading book, equity exposures can be assessed under standardised, simplified or IRB approaches.	For HSBC France reporting purposes, all equity exposures are treated under the IRB simplified approach, while previously in STD change till September 2017.
Securitisation	The CRR Framework specifies two methods for calculating credit risk requirements for securitisation positions in the non-trading book: the standardised approach and the IRB approach, which incorporates the Ratings Based Method ('RBM'), the Internal Assessment Approach ('IAA') and the Supervisory Formula Method ('SFM').	HSBC France only holds securitisation positions in banking books. CRR specifies two methods for calculating relevant credit risk, the standardised approach and the IRB approach. They both rely on the mapping of rating agency credit ratings to risk weights, which range from 7 per cent to 1,250 per cent. HSBC France uses the ratings-based IRB method except for liquidity facilities and programme-wide enhancements for asset-backed securitisations for which the full internal IRB assessment approach is applied.
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.	The risks presented above are measured by HSBC France via internal models when approved by the ECB and the PRA, except the specific risk which is captured through the standardised approach. Internal Market Risk models are based on VaR and Stressed VaR.
Operational risk	The CRR includes a capital requirement for operational risk, once again based on three levels of sophistication. The capital required under the basic indicator approach is a simple percentage of gross revenues. Under the standardised approach banks apply different percentages to the total operating income to each of eight defined business lines. Finally, the advanced measurement approach uses banks' own statistical analysis and modelling of operational risk data to determine capital requirements.	We have historically adopted and currently use the standardised approach in determining our operational risk capital requirement.

Pillar 2 and ICAAP

Pillar 2

Pillar 2 (Supervisory and own funds management process) consists of the own assessment by banks and of the assessment from supervision authorities, of the need to allocate capital resources to risks that are not covered by Pillar 1 framework. A major tool of the Pillar 2 is the Internal Capital Adequacy Assessment Process ('ICAAP'), conducted by HSBC France, to determine a forward-looking assessment of its capital requirements given its business strategy, risk profile, risk appetite and capital plan. This process incorporates HSBC France's risk management processes and governance framework. As part of this ICAAP, a range of stress tests are applied to our base capital plan. These tests, coupled with its economic capital framework and other risk management practices, are used to assess our internal capital adequacy internal evaluation by HSBC France.

This evaluation process is summarised in an annual ICAAP report. The ICAAP is approved by the Board, which has the ultimate responsibility for the effective management of risk and approval of HSBC France's risk appetite. It is then submitted to the supervisory authorities.

Pillar 2 definition is embedded in a broader Supervisory Review and Evaluation Process ('SREP'), which leads to an annual determination of individual capital requirement and guidance under Pillar 2. This process can also include specific demands on capital, liquidity and other aspects of the bank's management. The SREP process results in a Pillar 2 requirement and a Pillar 2 guidance that are added to the Pillar 1 requirements.

The Overall Capital Requirement, applicable on total capital is composed of the Pillar 1 requirement, the Pillar 2 requirement add-on, and the cumulated buffers. This stands as the applicable regulatory minimum on Total capital for an bank falling under ECB supervision.

The Total SREP capital requirement composed only of the Pillar 1 requirement and the Pillar 2 requirement add-on, applicable on the total capital ratio as well, is the ratio that banks should respect under stressed scenarios.

The Pillar 2 guidance applies on CET1 ratio, and compose the applicable regulatory minimum on CET1 along with the Pillar 1 requirement, the Pillar 2 requirement and the combined buffer.

Pillar 2 requirement is binding, and breaches can have direct legal consequences for the bank, for example with regards to dividends as well as coupons payments.

HSBC France's Overall Capital Requirement was at 11.88 per cent in 2017 and has been defined at 12.63 per cent in 2018. This change is a result of:

- The phase in of the capital conservation buffer from 1.25 per cent in 2017 to 1.875 per cent in 2018;
- The change in the Pillar II requirement from 2.63 per cent in 2017 to 2.75 per cent in 2018.

Internal capital adequacy assessment

The Board approves the ICAAP, and together with RMM, it examines the Bank's regulatory and economic capital profiles, aiming to ensure that capital resources:

- remain sufficient to support our risk profile and outstanding commitments;
- exceed current regulatory requirements, and that the bank 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 the strategic and operational goals, and the shareholder and investor expectations.

The minimum regulatory capital that HSBC France is required to hold is determined by the rules and guidance established by the Joint Supervisory Team. These capital requirements are a primary influence shaping the business planning process, in which RWA targets are established for global businesses in accordance with the bank'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 the management of risk.

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 per cent level of confidence.

The ICAAP and its constituent economic capital calculations are examined by the Joint Supervisory Team as part of its supervisory review and evaluation process. This examination informs the regulator's view of the Pillar 2 capital requirement and guidance.

A strong level of integration between risk and capital management frameworks helps to optimise the 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, and pension risk.

Financial Conglomerate

HSBC France holds an Insurance activity subsidiary, and as such, has been identified by the ECB as a financial conglomerate. Therefore, the bank is submitted to a supplementary conglomerate supervision by the ECB.

In this context, the conglomerate ratio is defined as the ratio between the total capital within the financial conglomerate, and the capital requirement due banking status cumulated with the capital requirement due to insurance status. The required minimum for this indicator is 100 per cent. At HSBC France's level, the excess of capital towards this indicators is of EUR 1.7 billion as at 2017.

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 from the 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 HSBC France's approach to managing credit risk (including details of the past due and impaired exposure, and its approach to credit risk impairment) can be found on page 63 of the HSBC France *Annual Report and Accounts 2017*.

Table 7: Credit risk exposure – summary

	Footnotes	Exposure value €m	RWAs €m	Capital required €m
IRB advanced approach		**52,669**	**16,549**	**1,324**
– central governments and central banks		**1,413**	**172**	**14**
– institutions		**1,392**	**450**	**36**
– corporates	1	**27,934**	**13,040**	**1,043**
– total retail		**21,930**	**2,887**	**231**
– *of which:*		**—**	**—**	**—**
secured by mortgages on immovable property – small- and medium-sized enterprises ('SME')		***528***	***329***	***26***
secured by mortgages on immovable property non-SME		***3,098***	***557***	***45***
qualifying revolving retail		***1***	***—***	***—***
other SME		***1,902***	***707***	***57***
other non-SME		***16,401***	***1,294***	***103***
IRB securitisation positions		**2,076**	**194**	**16**
IRB equity		**387**	**853**	**68**
IRB foundation approach		**305**	**302**	**24**
– central governments and central banks		**—**	**—**	**—**
– institutions		**—**	**—**	**—**
– corporates		**305**	**302**	**24**
Standardised approach		**30,723**	**4,548**	**364**
– central governments and central banks		**23,977**	**—**	**—**
– public sector entities		**10**	**2**	**—**
– international organisations		**1,391**	**—**	**—**
– institutions		**425**	**86**	**7**
– corporates		**2,130**	**1,431**	**114**
– retail		**503**	**334**	**27**
– secured by mortgages on immovable property		**278**	**97**	**8**
– exposures in default		**75**	**90**	**7**
– items associated with particularly high risk		**—**	**—**	**—**
– claims in the form of collective investments undertakings		**—**	**—**	**—**
– equity		**—**	**—**	**—**
– other items	2	**1,934**	**2,508**	**201**
At 31 Dec 2017		**86,160**	**22,446**	**1,796**
IRB advanced approach		50,612	15,469	1,238
– central governments and central banks		1,692	234	19
– institutions		1,500	523	42
– corporates	1	25,854	12,049	964
– total retail		21,566	2,663	213
– *of which*		—	—	—
secured by mortgages on immovable property SME		*582*	*171*	*14*
secured by mortgages on immovable property non-SME		*3,313*	*591*	*47*
qualifying revolving retail		*1*	*—*	*—*
other SME		*2,150*	*631*	*50*
other non-SME		*15,520*	*1,270*	*102*
IRB securitisation positions		2,724	227	18
IRB equity		—	—	—
IRB foundation approach		254	198	16
– central governments and central banks		—	—	—
– institutions		—	—	—
– corporates		254	198	16
Standardised approach		24,167	4,971	397
– central governments and central banks		16,351	—	—
– public sector entities		—	—	—
– international organisations		2,607	—	—
– institutions		316	65	5
– corporates		1,436	1,075	86
– retail		771	504	40
– secured by mortgages on immovable property		312	109	9
– exposures in default		50	65	5
– items associated with particularly high risk		322	483	39
– claims in the form of collective investments undertakings		—	—	—
– equity		141	141	11
– other items	2	1,861	2,529	202
At 31 Dec 2016		77,757	20,865	1,669

1 'Corporates' includes specialised lending exposures subject to supervisory slotting approach.
2 'Other items' includes investment in insurance companies that are risk weighted at 250 per cent.

Table 8: Credit risk exposure – by region

	Footnotes	France	European Union	Other	Total
		€m	€m	€m	€m
IRB advanced approach		**44,070**	**3,252**	**5,347**	**52,669**
– central governments and central banks		**—**	**530**	**883**	**1,413**
– institutions		**754**	**253**	**385**	**1,392**
– corporates	1	**21,451**	**2,465**	**4,018**	**27,934**
– total retail		**21,865**	**4**	**61**	**21,930**
– *of which:*					
secured by mortgages on immovable property SME		***527***	***—***	***1***	***528***
secured by mortgages on immovable property non-SME		***3,098***	***—***	***—***	***3,098***
qualifying revolving retail		***1***	***—***	***—***	***1***
other SME		***1,838***	***4***	***60***	***1,902***
other non-SME		***16,401***	***—***	***—***	***16,401***
IRB securitisation positions		**1,529**	**547**	**—**	**2,076**
IRB equity		**315**	**64**	**8**	**387**
IRB foundation approach		**305**	**—**	**—**	**305**
– central governments and central banks		**—**	**—**	**—**	**—**
– institutions		**—**	**—**	**—**	**—**
– corporates		**305**	**—**	**—**	**305**
Standardised approach		**25,160**	**3,650**	**1,913**	**30,723**
– central governments and central banks		**20,836**	**3,103**	**38**	**23,977**
– public sector entities		**10**	**—**	**—**	**10**
– international organisations		**—**	**—**	**1,391**	**1,391**
– institutions		**79**	**159**	**187**	**425**
– corporates		**1,450**	**383**	**297**	**2,130**
– retail		**498**	**5**	**—**	**503**
– secured by mortgages on immovable property		**278**	**—**	**—**	**278**
– exposures in default		**75**	**—**	**—**	**75**
– items associated with particularly high risk		**—**	**—**	**—**	**—**
– claims in the form of CIU		**—**	**—**	**—**	**—**
– equity		**—**	**—**	**—**	**—**
– other items	2	**1,934**	**—**	**—**	**1,934**
At 31 Dec 2017		**71,379**	**7,513**	**7,268**	**86,160**
IRB advanced approach		42,878	2,291	5,443	50,612
– central governments and central banks		—	—	1,692	1,692
– institutions		1,123	106	271	1,500
– corporates	1	20,244	2,173	3,437	25,854
– total retail		21,511	12	43	21,566
– *of which:*					
secured by mortgages on immovable property SME		*581*	*—*	*1*	*582*
secured by mortgages on immovable property non-SME		*3,311*	*—*	*2*	*3,313*
qualifying revolving retail		*1*	*—*	*—*	*1*
other SME		*2,098*	*12*	*40*	*2,150*
other non-SME		*15,520*	*—*	*—*	*15,520*
IRB securitisation positions		2,469	255	—	2,724
IRB equity		—	—	—	—
IRB foundation approach		254	—	—	254
– central governments and central banks		—	—	—	—
– institutions		—	—	—	—
– corporates		254	—	—	254
Standardised approach		15,951	5,149	3,067	24,167
– central governments and central banks		11,494	4,857	—	16,351
– public sector entities		—	—	—	—
– international organisations		—	—	2,607	2,607
– institutions		112	107	97	316
– corporates		916	166	354	1,436
– retail		756	15	—	771
– secured by mortgages on immovable property		312	—	—	312
– exposures in default		50	—	—	50
– items associated with particularly high risk		321	—	1	322
– claims in the form of CIU		—	—	—	—
– equity		129	4	8	141
– other items	2	1,861	—	—	1,861
At 31 Dec 2016		61,552	7,695	8,510	77,757

For footnotes, see page 11

Table 9: Credit risk exposure – by industry sector

	Footnotes	Personal €m	Manufacturing €m	International trade and services €m	Property and other business activities €m	Government and public administration €m	Other commercial €m	Financial €m	Non-customer assets €m	Total €m
IRB advanced approach		19,500	3,512	4,837	14,573	2,495	2,646	5,106	–	52,669
– central governments and central banks		–	–	–	–	1,413	–	–	–	1,413
– institutions		–	–	–	–	–	–	1,392	–	1,392
– corporates	1	–	3,272	4,226	13,398	972	2,382	3,684	–	27,934
– total retail		19,500	240	612	1,175	110	264	29	–	21,930
– *of which:*		–	–	–	–	–	–	–	–	–
secured by mortgages on immovable property SME		–	*7*	*16*	*493*	*4*	*5*	*3*	–	*528*
secured by mortgages on immovable property non-SME		*3,098*	–	–	–	–	–	–	–	*3,098*
qualifying revolving retail		*1*	–	–	–	–	–	–	–	*1*
other SME		–	*233*	*596*	*682*	*106*	*259*	*26*	–	*1,902*
other non-SME		*16,401*	–	–	–	–	–	–	–	*16,401*
IRB securitisation positions		–	–	–	–	–	–	2,076	–	2,076
IRB equity		–	–	–	157	–	–	230	–	387
IRB foundation approach		–	61	71	70	8	91	4	–	305
– central governments and central banks		–	61	71	70	8	91	4	–	305
– institutions		–	–	–	–	–	–	–	–	–
– corporates		–	–	–	–	–	–	–	–	–
Standardised approach		264	31	45	1,127	5,180	114	22,815	1,147	30,723
– central governments and central banks		–	–	–	–	3,487	–	20,490	–	23,977
– public sector entities		–	–	–	–	10	–	–	–	10
– international organisations		–	–	–	–	1,391	–	–	–	1,391
– institutions		–	–	–	–	–	–	425	–	425
– corporates		–	31	42	576	55	104	1,322	–	2,130
– retail		175	–	–	297	11	5	15	–	503
– secured by mortgages on immovable property		64	–	–	210	–	4	–	–	278
– exposures in default		25	–	3	44	1	1	1	–	75
– items associated with particularly high risk		–	–	–	–	–	–	–	–	–
– claims in the form of CIU		–	–	–	–	–	–	–	–	–
– equity		–	–	–	–	–	–	–	–	–
– other items	2	–	–	–	–	225	–	562	1,147	1,934
At 31 Dec 2017		**19,764**	**3,604**	**4,953**	**15,927**	**7,683**	**2,851**	**30,231**	**1,147**	**86,160**

For footnotes, see page 11.

Table 10: Credit risk exposure – by maturity

	Footnotes	Less than 1 year €m	Between 1 and 5 years €m	More than 5 years €m	Undated €m	Total €m
IRB advanced approach		8,208	21,462	22,999	—	52,669
– central governments and central banks		406	944	63	—	1,413
– institutions		532	649	211	—	1,392
– corporates	1	6,255	15,913	5,766	—	27,934
– total retail		1,015	3,956	16,959	—	21,930
– *of which:*		—	—	—	—	—
secured by mortgages on immovable property SME		8	104	416	—	528
secured by mortgages on immovable property non-SME		19	367	2,712	—	3,098
qualifying revolving retail		—	1	—	—	1
other SME		804	911	187	—	1,902
other non-SME		184	2,573	13,644	—	16,401
IRB securitisation positions		1,271	805	—	—	2,076
IRB equity		—	—	—	387	387
IRB foundation approach		10	234	61	—	305
– central governments and central banks		—	—	—	—	—
– institutions		—	—	—	—	—
– corporates		10	234	61	—	305
Standardised approach		18,266	8,692	1,887	1,878	30,723
– central governments and central banks		16,964	5,917	1,096	—	23,977
– public sector entities		—	—	10	—	10
– international organisations		226	806	359	—	1,391
– institutions		279	132	14	—	425
– corporates		648	1,263	219	—	2,130
– retail		103	287	113	—	503
– secured by mortgages on immovable property		33	178	67	—	278
– exposures in default		13	53	9	—	75
– items associated with particularly high risk		—	—	—	—	—
– claims in the form of CIU		—	—	—	—	—
– equity		—	—	—	—	—
– other items	2	—	56	—	1,878	1,934
At 31 Dec 2017		**27,755**	**31,193**	**24,947**	**2,265**	**86,160**
IRB advanced approach		10,956	17,994	21,662	—	50,612
– central governments and central banks		69	1,489	134	—	1,692
– institutions		564	710	226	—	1,500
– corporates	1	8,753	12,250	4,851	—	25,854
– total retail		1,570	3,545	16,451	—	21,566
– *of which:*		—	—	—	—	—
secured by mortgages on immovable property SME		9	98	475	—	582
secured by mortgages on immovable property non-SME		22	285	3,006	—	3,313
qualifying revolving retail		1	—	—	—	1
other SME		1,004	961	185	—	2,150
other non-SME		534	2,201	12,785	—	15,520
IRB securitisation positions		1,930	788	6	—	2,724
IRB equity		—	—	—	—	—
IRB foundation approach		9	200	45	—	254
– central governments and central banks					—	
– institutions					—	
– corporates		9	200	45	—	254
Standardised approach		6,996	12,679	2,216	2,276	24,167
– central governments and central banks		5,842	8,987	1,522	—	16,351
– public sector entities		—	—	—	—	—
– international organisations		387	1,917	303	—	2,607
– institutions		119	194	3	—	316
– corporates		395	818	223	—	1,436
– retail		159	512	100	—	771
– secured by mortgages on immovable property		63	188	61	—	312
– exposures in default		31	15	4	—	50
– items associated with particularly high risk		—	—	—	322	322
– claims in the form of CIU		—	—	—	—	—
– equity		—	—	—	141	141
– other items	2	—	48	—	1,813	1,861
At 31 Dec 2016		19,891	31,661	23,929	2,276	77,757

For footnotes, see page 11.

Table 11: Wholesale IRB exposures under the slotting approach

	Exposure	
	2017	2016
	€m	€m
Supervisory Category		
Category 1 – Strong	**1,094**	902
Category 2 – Good	**238**	314
Category 3 – Satisfactory	**9**	–
Category 4 – Weak	**–**	–
Category 5 – Default	**–**	–
At 31 Dec	**1,341**	1,216

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 in the HSBC France Annual Report and Accounts 2017, and HSBC France's definitions for accounting purposes of 'past due' and 'impaired' are set out on page 81.

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

Table 12: Amount of impaired exposures and related allowances by industry sector and geographical region

	Total
	€m
At 31 Dec 2017	
Past due but not impaired exposures	**151**
– personal	**97**
– corporate and commercial	**54**
– financial	**–**
Impaired exposures	**971**
– personal	**302**
– corporate and commercial	**668**
– financial	**1**
Impairment allowances and other credit risk provisions	**535**
– personal	**82**
– corporate and commercial	**452**
– financial	**1**
At 31 Dec 2016	
Past due but not impaired exposures	223
– personal	156
– corporate and commercial	67
– financial	–
Impaired exposures	1,200
– personal	308
– corporate and commercial	872
– financial	20
Impairment allowances and other credit risk provisions	624
– personal	85
– corporate and commercial	520
– financial	19

Table 13: Movement in specific credit risk adjustments by industry sector and by geographical region

	Total
	€m
Specific credit risk adjustments at 1 Jan 2017	**624**
Amounts written off	**(170)**
– personal	**(13)**
– corporate and commercial	**(157)**
– financial	**—**
Recoveries of amounts written off in previous years	**(3)**
– personal	**(1)**
– corporate and commercial	**(2)**
– financial	**—**
Charge to income statement	**84**
– personal	**10**
– corporate and commercial	**77**
– financial	**(3)**
Exchange and other movements	**—**
Specific credit risk adjustments at 31 Dec 2017	**535**
Specific credit risk adjustments at 1 Jan 2016	686
Amounts written off	(131)
– personal	(19)
– corporate and commercial	(107)
– financial	(5)
Recoveries of amounts written off in previous years	3
– personal	1
– corporate and commercial	2
– financial	—
Charge to income statement	73
– personal	15
– corporate and commercial	47
– financial	11
Exchange and other movements	(7)
Specific credit risk adjustments at 31 Dec 2016	624

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. Through this analysis we are able to understand changes occurring in the risk profile of our exposures and the implications of these changes for risk and capital management.

This analysis includes comparison of the EL calculated in the use of IRB risk rating models, which drives part of the regulatory capital calculation, with other reported measures of credit loss within financial statements prepared under IFRS. These measures include loan impairment allowances, value adjustments and credit related provisions for off-balance sheet amounts, collectively referred to as CRAs. The excess of EL over CRAs is treated as a capital deduction in the composition of regulatory capital.

The disclosures below set out:

- commentary on aspects of the relationship between regulatory EL and CRAs recognised in our financial statements; and
- tables of EL and CRA balances and charges during the period by exposure class (within retail IRB, also by sub-class).

When comparing EL with measures of credit losses under IFRS, it is necessary to take into account differences in the definition and scope of each. Below are examples of matters that 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.

Table 14 set out, for IRB credit exposures, the EL, CRA balances and the actual loss experience reflected in the charges for CRAs.

CRA balances represent management's best estimate of losses incurred in the loan portfolios at the balance sheet date. Charges for CRAs represent a movement in the CRA balance during the year, reflecting loss events that occurred during the financial year and changes in estimates of losses arising on events that occurred prior to the current year. EL represents the one-year regulatory expected loss accumulated in the book at the balance sheet date.

From 1 January 2018, IFRS 9 will change the way credit losses are measured for accounting purposes. IFRS 9 is conceptually more aligned with the IRB measurement of expected loss and uses similar building blocks such as Probability of Default, Loss Given Default and Expected Loss. Significant differences between regulatory and accounting measures of expected loss will continue under IFRS 9 due to factors such as: the removal of regulatory conservatism and supervisory set parameters under IFRS, point in time and forward - looking measurements under IFRS compared to through the cycle measures under regulatory, 12 month expected losses under regulatory versus lifetime expected losses under IFRS, different discount rates for recoveries / future cash flows.

Examples of differences in definition and scope between EL and CRA balances

- Under IAS 39, our estimates of loss in impairment allowances are required to reflect the current circumstances and specific cash flow expectations of a customer. EL is based on modelled estimates and, although the estimates may be individually assigned to specific exposures, the statistical nature of these models means that they are influenced by the behaviour of the overall portfolio;
- EL is based on exposure values that incorporate expected future drawings of committed credit lines, while CRAs are recognised in respect of financial assets recognised on the balance sheet and in respect of committed credit lines where a loss is probable;
- EL is generally based on Through-the-Cycle ('TTC') estimates of PD over a one-year future horizon, determined via statistical analysis of historical default experience. CRAs are recognised for losses that have been incurred at the balance sheet date;
- EL incorporates LGD, which may discount recoveries at a different rate from the effective interest rate employed in discounted cash flow analysis for CRAs;
- LGDs typically include all costs associated with recovery, whereas the accounting measurement considers only the costs of obtaining and selling collateral;
- In the foundation IRB approach, LGD and the conversion factors used to calculate EAD are set by regulations, and may differ significantly from the accounting assumptions about estimated cash flows;
- for EL, certain exposures are subject to regulatory minimum thresholds for one or more parameters, whereas credit losses under IFRSs are determined using management's judgement about estimated future cash flows; and
- in the case of EL, to meet regulatory prudential standards, HSBC's model philosophy favours the incorporation of conservative estimation to accommodate uncertainty; for instance, where modelling portfolios with limited data. Under IFRSs, uncertainty is considered when forming management's estimates of future cash flows, using balanced and neutral judgement.

Table 14: IRB expected loss and CRA – by exposure class

		CRA[1]	
	Expected loss[1]	Balances	Charge for the year
	€m	€m	€m
IRB exposure classes			
Central governments and central banks	–	–	–
Institutions	1	–	–
Corporates	252	203	72
Retail	365	321	7
– secured by mortgages on immovable property SME	9	4	–
– secured by mortgages on immovable property non-SME	51	44	3
– qualifying revolving retail	–	–	–
– other SME	222	206	(1)
– other non-SME	83	67	5
At 31 Dec 2017	618	524	79

Table 14: IRB expected loss and CRA – by exposure class (continued)

	Expected loss[1]	CRA[1]	
		Balances	Charge for the year
	€m	€m	€m
IRB exposure classes			
Central governments and central banks	—	—	—
Institutions	1	—	—
Corporates	306	273	34
Retail	395	342	39
– secured by mortgages on immovable property SME	10	3	1
– secured by mortgages on immovable property non-SME	53	47	5
– qualifying revolving retail	—	—	—
– other SME	246	223	25
– other non-SME	86	69	8
At 31 Dec 2016	702	615	73

1 *Excludes securitisation exposures because EL is not calculated for this exposure class.*

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 often taken to help secure claims. Another common form of security for the Retail business is guarantees provided by a third party company; *Crédit Logement* (a *Société de Financement* regulated by the French Regulator ACPR). *Crédit Logement* guarantees 100 per cent of the amount of the residential home loan in case of default. Loans to private banking and higher wealth clients may be made against a pledge of eligible marketable securities, cash or real estate. 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.

Further information regarding charges held over residential and commercial property is provided on page 85 of the HSBC France Annual Report and Accounts 2017*.*

Financial collateral

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

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.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, collateral values are determined through a combination of professional appraisals, external valuation database companies or house price indices. Specifically, HSBC France utilises the notary price index (INSEE) to update its mortgage portfolio value on a monthly basis. In addition it obtains professional valuations for its high value mortgage loans (3m EUR) annually for any loan impaired.

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 the second category, LGD estimates are affected by a wider range of collateral, including cash, guarantees provided by *Crédit Logement*, charges over real estate property, fixed assets, trade goods, receivables. 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. As noted previously, Retail home loan lending is often secured via a guarantee provided by the third party financial institution; *Crédit Logement*. As *Crédit Logement* guarantees all unpaid installments and potential final losses, this has an impact on the observed LGD.

EAD and LGD values, in the case of individually assessed exposures, are determined by 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. A range of collateral recognition approaches are applied to IRB capital treatments:

- unfunded protection, which includes guarantees, is reflected through adjustment or determination of PD or LGD;
- eligible financial collateral information is taken into account in LGD models (under Advanced IRB); 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.

The table 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 16 sets out the credit risk mitigation for exposures under the standardised approach, expressed as the exposure value covered by the credit risk mitigant.

Table 15: IRB exposure – credit risk mitigation

	2017			2016		
	Exposure value covered by eligible financial and other collateral	**Exposure value covered by credit derivatives or guarantees**	**Total exposure value**	Exposure value covered by eligible financial and other collateral	Exposure value covered by credit derivatives or guarantees	Total exposure value
	€m	**€m**	**€m**	€m	€m	€m
Exposures under the IRB advanced	**9,662**	**14,504**	**24,166**	9,919	14,889	24,808
– central governments and central banks	**–**	**–**	**–**	–	–	–
– institutions	**–**	**1**	**1**	1	1	2
– corporates	**5,010**	**1,169**	**6,179**	4,537	1,507	6,044
– retail	**4,652**	**13,334**	**17,986**	5,381	13,381	18,762
Exposures under the IRB foundation approach	**–**	**–**	**–**	–	–	–
– Institutions	**–**	**–**	**–**	–	–	–
– Corporates	**–**	**–**	**–**	–	–	–
At 31 Dec	**9,662**	**14,504**	**24,166**	9,919	14,889	24,808

Table 16: Standardised exposure – credit risk mitigation

	2017			2016		
	Exposure value covered by eligible financial and other collateral	**Exposure value covered by credit derivatives or guarantees**	**Total exposure value**	Exposure value covered by eligible financial and other collateral	Exposure value covered by credit derivatives or guarantees	Total exposure value
	€m	**€m**	**€m**	€m	€m	€m
Exposures under the standardised approach						
Central governments and central banks	**–**	**–**	**–**	–	–	–
Institutions	**–**	**–**	**–**	–	–	–
Corporates	**340**	**330**	**670**	369	60	429
Retail	**130**	**930**	**1,060**	39	355	394
Secured by mortgages on immovable property	**23**	**11**	**34**	–	–	–
Exposures in default	**–**	**11**	**11**	–	–	–
Items associated with particularly high risk	**–**	**–**	**–**	–	–	–
At 31 Dec	**493**	**1,282**	**1,775**	408	415	823

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 HSBC France's approach to managing counterparty credit risk can be found on page 86 of the HSBC France Annual Report and Accounts 2017.

Table 17: Counterparty credit risk[1] – RWAs by exposure class and product

	2017		2016	
	RWAs	Capital	RWAs	Capital required
	€m	€m	€m	€m
By exposure class				
IRB advanced approach	**685**	**55**	867	69
– central governments and central banks	**—**	**—**	—	—
– institutions	**685**	**55**	867	69
– corporates	**—**	**—**	—	—
IRB foundation approach	**638**	**51**	1,068	85
– corporates	**638**	**51**	1,068	85
Standardised approach	**422**	**34**	450	36
– central governments and central banks	**—**	**—**	—	—
– institutions	**419**	**34**	449	36
– corporates	**3**	**—**	1	—
CVA advanced	**—**	**—**	—	—
CVA standardised	**1,128**	**90**	1,191	95
CCP standardised	**163**	**13**	131	10
By products				
– derivatives (OTC and Exchange traded derivatives)	**1,784**	**143**	2,329	186
– SFTs	**73**	**6**	124	10
– other	**—**	**—**	—	—
– CVA advanced	**—**	**—**	—	—
– CVA standardised	**1,128**	**90**	1,191	95
– CCP default funds	**51**	**4**	63	5
At 31 Dec	**3,036**	**243**	**3,707**	**296**

1 *includes settlement risk*

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 ECB, approved local VaR models or the standardised approach for position risk under CRD IV.

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

Further explanation of the HSBC France's approach to managing market risk can be found on page 91 of the HSBC France Annual Report and Accounts *2017.*

Table 18: Market risk – RWA and capital required

	Footnotes	2017		2016	
		RWAs	**Capital required**	RWAs	Capital required
		€m	**€m**	€m	€m
Internal model based		**4,787**	**383**	7,603	608
– VaR	1	**1,191**	**95**	2,358	188
– stressed VaR	1	**3,596**	**288**	5,245	420
– incremental risk charge		**—**	**—**	—	—
– other VaR and stressed VaR		**—**	**—**	—	—
Standardised approach		**401**	**32**	304	25
– interest rate position risk		**356**	**28**	269	22
– foreign exchange position risk		**—**	**—**	—	—
– equity position risk		**—**	**—**	—	—
– commodity position risk		**—**	**—**	—	—
– securitisations		**—**	**—**	—	—
– options		**45**	**4**	35	3
At 31 Dec		**5,188**	**415**	7,907	633

1 *Internal model based RWAs include RWAs arising from Risks not in VAR ('RNIV')*

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, in particular legal, compliance, 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:

- external criminal activities, including fraud;
- breakdowns in processes/procedures due to human error, misjudgement or malice;
- system failure or non-availability; and
- breach of regulatory and/or legislative requirements.

Further explanation of HSBC France's approach to managing operational risk can be found on page 99 of the HSBC France Annual Report and Accounts *2017.*

Table 19: Operational risk RWA

	2017		2016	
	RWAs	**Capital required**	RWAs	Capital required
	€m	**€m**	€m	€m
Own funds requirement for operational risk	**3,385**	**271**	3,537	283

Other risks

Further details of the other risks identified by HSBC France are described in the Top and Emerging Risks section which can be found on pages 63 to 121 in the HSBC France *Annual Report and Accounts 2017*.

Interest rate risk in the banking book

The 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 the BSM to manage, in accordance with internal transfer pricing rules. In its management of IRRBB, the group aims to balance mitigating the effect of future interest rate movements which could reduce net interest income against the cost of hedging. The monitoring of the projected net interest income and economic value of equity ('EVE') sensitivity under varying interest rate scenarios is a key part of this.

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. An EVE sensitivity is the extent to which the EVE value will change due to a pre-specified movements in interest rates, where all other economic variables are held constant.

Further details on our IRRBB may be found on page 97 of HSBC France's Annual Report and Accounts 2017.

Risk management of insurance operations

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

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.

We choose to manufacture these insurance products in HSBC France subsidiary 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 HSBC France.

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 HSBC France a combination of commissions and fees.

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 business is exposed to. The methodology for the economic capital calculation is largely aligned to the pan-European Solvency II insurance capital regulations, which are applicable from 2016.

Further details of the management of financial risks and insurance risk arising from the insurance operations are provided from page 116 of the HSBC France Annual Report and Accounts 2017.

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. The group's policy is that it should be self-sufficient in funding its own activities.

Structure and organisation of the liquidity risk management function

The Group Treasurer, who reports to the Group CFO, has responsibility for the oversight of the LFRF. Asset, Liability and Capital Management ('ALCM') team are responsible for the application of the LFRF with HSBC France.

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.

Group Treasury/Asset, Liability & Capital Management ('ALCM')

The Group Treasury team is responsible for setting the Group's policy, proposing risk tolerance and providing review and challenge of the operating entities implementation. 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') teams 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.

Liquidity Risk Assurance

Second line liquidity risk assurance is provided through the Group's Risk function. This team performs the following activities:

- reviews and challenges assumptions of the 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 debits and credits over an account 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 manage liquidity risk and funding risks on a stand-alone basis in accordance with the LFRF, which includes the preparation of an Individual Liquidity Adequacy Assessment ('ILAA') document, to ensure that:

- liquidity resources are adequate, both as to the 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
- that the operating entity's liquidity risk framework is adequate and robust.

The two key objectives of the ILAA process are to:

- demonstrate that all material liquidity and funding risks are captured within the internal framework; and
- 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 ILAA, 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 maintains a prudent funding profile.

Liquidity stress testing

The group 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. The group also conducts reverse stress testing with the specific aim of reviewing the remoteness of the scenarios that would lead the group 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;
- operating entity classification by inherent liquidity risk ('ILR') categorisation;
- minimum LCR requirement depending on 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

The structural foreign exchange exposition of HSBC France is limited. It concerns few investments, not significant, in the foreign subsidiaries, as structural foreign exchange exposition arising from banking operations is systematically transferred to the trading room which manages exchange rate risk according to the limits set by the Risk Management Committee.

The exchange rate risk on equity is due to investments in foreign currency that are not hedged by financing in foreign currency. This exposure corresponds to net investments in subsidiaries, branches or associated companies for which the euro is not the functional currency.

HSBC France's investments in foreign subsidiaries are small in amount. The structural foreign exchange exposure is mainly linked to these subsidiaries' profits retained in reserves.

HSBC France monitors this risk through an indicator of exposure and capital ratios sensitivity to movements in main currencies, calculated by the Finance Department.

As at 2017 year-end, circa. 3.3 per cent of the credit and counterparty risk RWAs are US dollar or GBP denominated. Apart from EUR and these, other currencies are non-significant within HSBC France's risk-weighted exposures.

For a combined variation of +/- 20 per cent of both GBP and US dollar against EUR, the estimated impact on the CET 1 ratio is of circa. +/- 0.15 per cent.

Reputational risk

Reputational risk relates to stakeholders' perceptions, whether fact-based or otherwise. Stakeholders' expectations change constantly and so reputational risk is dynamic and varies between geographical regions, groups and individuals. We have an unwavering commitment to operating at the high standards we set for ourselves in every jurisdiction. Any lapse in standards of integrity, compliance, customer service or operating efficiency represents a potential reputational risk. We have taken, and are taking, measures to enhance our AML, sanctions and other regulatory compliance frameworks. These measures should also enhance our reputational risk management in the future.

For further details, please refer to the Reputational Risk section on page 121 of the HSBC France Annual Report and Accounts 2017*.*

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; 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.

Climate-related risks are divided into two major categories: (1) risks related to the transition to a lower-carbon economy and (2) risks related to the physical impacts of climate change.

Transition risk, in the context of climate change, is the risk that the ability of a customer/counterparty to meet its financial obligations deteriorates as a consequence of the transition from a high-carbon to a low-carbon economy. More information on how HSBC France is taking transition risk into account can be found in the 2017 annual report.

Business risk

Business risk is the potential negative impact on profits and capital as a result of HSBC France not meeting its strategic objectives, as set out in the strategic plan, caused by unforeseen changes in the business and regulatory environment, exposure to economic cycles and technological changes.

Business risk is assessed through particular macro-economic scenario, involving specific and relevant political items, within stress-testing exercises.

Remuneration

As a subsidiary of HSBC Group, the general remuneration principles implemented within HSBC France are very naturally part of the broader framework of the HSBC Group's remuneration policy which is subject to the rules laid down by the British regulators (i.e mainly Prudential Regulatory Authority). In addition, these remuneration principles are applied taking into account the local regulatory framework and any European specific regulations. Details of HSBC France remuneration policy may be found in the report on corporate governance on pages 34 to 42 of the HSBC France *Annual Report and Accounts 2017*.

The following tables show the remuneration awards made to MRTs in HSBC France for 2017.

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. The tables below include the total remuneration of individuals identified as HSBC MRTs based on their role and professional activities who could have a potential impact on the risk profile of the Bank.

Table 20: Aggregate remuneration expenditure

	By Global business					
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Corporate Centre	Total
	€m	€m	€m	€m	€m	€m
Aggregate remuneration expenditure[1]						
2017	**3.3**	**2.6**	**33.4**	**1.1**	**8.9**	**49.3**
2016	3.5	2.3	33.2	1.1	7.4	47.5

1 *Includes base salary, any other form of fixed pay, incentives awarded in respect of the performance year (including deferred component) but excluding any return on deferred cash awards.*

Table 21: Remuneration – fixed and variable amounts

	2017			2016		
	MRTs			MRTs		
	Senior management	Non-senior management	Total	Senior management	Non-senior management	Total
Number of MRTs	**2**	**77**	**79**	2	80	82
	€m	€m	€m	€m	€m	€m
Fixed						
Cash-based	**1.6**	**24.0**	**25.6**	1.6	25.2	26.8
Shares-based	**—**	**—**	**—**	—	—	
Total fixed	**1.6**	**24.0**	**25.6**	1.6	25.2	26.8
Variable[1]						
Cash	**0.4**	**7.1**	**7.5**	0.3	6.5	6.8
Non-deferred shares[2]	**0.4**	**5.4**	**5.8**	0.3	4.9	5.2
Deferred cash[3]	**0.5**	**5.1**	**5.6**	0.4	3.8	4.2
Deferred shares	**0.5**	**4.3**	**4.8**	0.4	4.0	4.4
Total variable pay[4]	**1.7**	**21.9**	**23.6**	1.6	19.1	20.7

1 *Variable pay awarded in respect of the performance year (including deferred component).*
2 *Vested shares, subject to a six-month or one year retention period.*
3 *Excluding any return on deferred cash awards.*
4 *In accordance with HSBC Holdings plc shareholder approval received on 23 May 2014, for each MRT, the variable component of remuneration for any one year is limited to 200 per cent of the fixed component of total remuneration of the MRT.*

Table 22: Deferred remuneration[1,2]

	2017			2016		
	MRTs			MRTs		
	Senior management	Non-senior management	Total	Senior management	Non-senior management	Total
Deferred remuneration at 31 Dec	€m	€m	€m	€m	€m	€m
Outstanding, unvested	**2.6**	**19.9**	**22.5**	2.6	20.9	23.5
Awarded during the year	**1.3**	**13.3**	**14.6**	0.9	9.8	10.7

1 *This table provides details of actions taken during the performance year. For details of variable pay awards granted for the performance year, please refer to the Remuneration tables above.*
2 *Values for share-based deferred remuneration included in the 'Outstanding, unvested' and 'Awarded during the year' totals are calculated using the HSBC Holdings Plc ('Euronext Paris) closing price on 29 December 2017. Values for share-based deferred remuneration included in the 'Paid out' or 'Reduced through malus' totals are based on the fair market value of the award on the date of vest or reduction.*

Table 23: Sign-on and severance payments

	2017			2016		
	MRTs			MRTs		
	Senior management	Non-senior management	Total	Senior management	Non-senior management	Total
Sign-on payments[1]						
Made during year (€m)	**—**	**0.2**	**0.2**	—	0.2	0.2
Number of beneficiaries	**—**	**1**	**1**	—	1	1
Severance payments[2]						
Awarded and made during year (€m)	**—**	**1.6**	**1.6**	—	3.3	3.3
Number of beneficiaries	**—**	**2**	**2**	—	2	2
Highest such award to single person (€m)	**—**	**1.4**	**1.4**	—	2.2	2.2

1 *Guaranteed variable pay awards granted to new hires and limited to their first year of service.*
2 *Represents non-standard termination payments made in excess of any local policies, standards or statutory amounts.*

Table 24: Material risk-takers (MRT) remuneration by band[1]

	2017			2016		
	Number of MRTs			Number of MRTs		
	Senior management	Non-senior management	Total	Senior management	Non-senior management	Total
€0 – €1,000,000	1	69	70	1	75	76
€1,000,001 – €1,500,000	—	4	4	—	3	3
€1,500,001 – €2,000,000	—	4	4	—	2	2
€2,000,001 – €2,500,000	1	—	1	1	—	1
€2,500,001 – €3,000,000	—	—	—	—	—	—
€3,000,001 – €3,500,000	—	—	—	—	—	—
€3,500,001 – €4,000,000	—	—	—	—	—	—
€4,000,001 – €4,500,000	—	—	—	—	—	—
€4,500,001 – €5,000,000	—	—	—	—	—	—
€5,000,001 – €6,000,000	—	—	—	—	—	—
€6,000,001 – €7,000,000	—	—	—	—	—	—
€7,000,001 – €8,000,000	—	—	—	—	—	—
€8,000,001 – €9,000,000	—	—	—	—	—	—
€9,000,001 – €10,000,000	—	—	—	—	—	—
€10,000,001 – €11,000,000	—	—	—	—	—	—

1 *Table prepared in euros in accordance with Article 450 of the Capital Requirements Regulation, using the rates published by the European Commission for financial programming and budget for December 2017, as published on their website.*

Appendix I

Summary of disclosures withheld due to their immateriality, confidentiality or proprietary nature

CRD IV reference	Description	Rationale
438(e) and 445	Capital requirements – Own funds requirements for settlement risk.	Materiality Settlement risk arises where certain transactions are unsettled after their due delivery date and is required to be separately disclosed. However, as settlement risk RWAs are not material and included within counterparty credit risk, they have not been separately disclosed.
442(c)	Credit Risk Adjustments – In relation to exposure to credit risk and dilution risk, the total amount of exposures after accounting offsets and without taking into account the effects of credit risk mitigation.	Materiality The disclosure has been made after taking into account the effects of credit risk mitigation; there are no significant differences between exposures pre- and post- credit risk mitigation at exposure class level.
448(a)	Key assumptions (including assumptions regarding loan prepayments and behaviour of non-maturity deposits) on their exposure to interest rate risk on positions not included in the trading book.	Proprietary Assumptions regarding fixed term loan repayments and term behaviouralisation of non-maturity deposits and capital drive HSBC's structural interest rates positioning and market hedging requirements. Disclosure could give key business strategy information to our competitors.

Appendix II

Abbreviations

The following abbreviated terms are used throughout this document.

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
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
CRA[1]	Credit risk adjustment
CRD IV[1]	Capital Requirements Regulation and Directive
CRE[1]	Commercial real estate
CRM	Credit risk mitigation/mitigant
CVA	Credit valuation adjustment
E	
EAD[1]	Exposure at default
EBA	European Banking Authority
EC	European Commission
ECB	European Centrale Bank
EEA	European Economic Area
EL[1]	Expected loss
EU	European Union
EVE[1]	Economic value of equity
F	
FPC[1]	Financial Policy Committee (UK)
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	
HSBC	HSBC Holdings together with its subsidiary undertakings
I	
IAA[1]	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	Internal Models Approach
IMM[1]	Internal Model Method
IRB[1]	Internal ratings based approach
IRC[1]	Incremental risk charge
IMA	Internal Models Approach
IMM[1]	Internal Model Method
IRB[1]	Internal ratings based approach
IRC[1]	Incremental risk charge
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
N	
NQH	Non Qualifying Hedge
NSFR	Net Stable Funding Ratio
O	
OTC[1]	Over-the-counter
P	
PD[1]	Probability of default
PFE[1]	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
RMM	Risk Management Meeting of the Group Management Board
RNIV	Risks not in VaR
RWA[1]	Risk-weighted asset
S	
S&P	Standard and Poor's rating agency
STD[1]	Standardised approach
CCR	Standardised approach for counterparty credit risk
SFM[1]	Supervisory Formula Method
SFT[1]	Securities Financing Transactions
SME	Small and medium-sized enterprise
T	
TLAC[1]	Total Loss Absorbing Capacity
TTC[1]	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 III

Cautionary statement regarding forward-looking statements

The Capital and Risk Management Pillar 3 Disclosures 2017 contains certain forward-looking statements with respect to HSBC's financial condition, results of operations, capital position and business.

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

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

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement. These 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, 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, notably compliance with the DPA.

HSBC France

103 avenue des Champs-Elysées
75419 Paris Cedex 08
France
Telephone: (33 1) 40 70 70 40
www.hsbc.fr