HSBC Holdings plc

Risk

HSBC

The world's local bank

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Chief Risk Officer, Asia-Pacific

Forward-looking statements

- **This presentation and subsequent discussion may contain certain forward-looking statements with respect to the financial condition, results of operations and business of the Group. These forward-looking statements represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Additional detailed information concerning important factors that could cause actual results to differ materially is available in our Interim Report. Past performance cannot be relied on as a guide to future performance.**

This presentation contains non-GAAP financial information. Reconciliation of non-GAAP financial information to the most directly comparable measures under GAAP can be found in HSBC's 2010 Interim Report in the Operating and Financial Review.

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- Risk outlook
- Loan impairment charges and non-performing loans
- Risk governance

Risk portfolios

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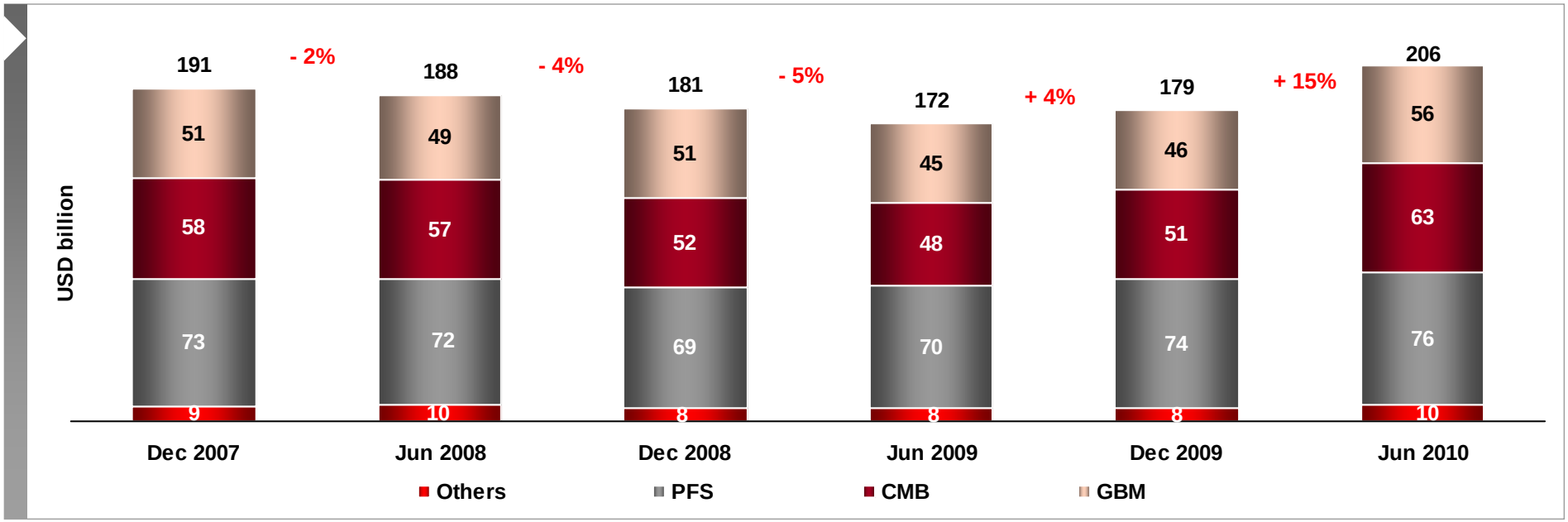
Customer advances



Concentration

- Well-balanced across customer groups
- No industry sector concentration concerns
- No geographic concentration concerns
- Focus on growth outside Hong Kong

Credit quality

- Investment grade advances steady
- Positive risk migration over past six months
- 30+ days lagged delinquency down
- LICs as per cent of customer advances down from 1.1 per cent (June 2009) to 0.8 per cent (June 2010)

Notes:
(1) Figures may not add up to totals due to rounding

Financial instruments by credit quality

- Adhere to disciplined investment framework
- Cautious – security of customer deposits
- 92 per cent are rated A or better
  - Central management of:
  - Interest rate risk
  - Currency risk
  - Tenor risk 53 per cent < 3 months

Management of market risks

- Philosophy and approach to market risk
- Nature of risk that we are running
- Level of complexity
- Main factors impacting upon our VaR performance
  - Spot FX
  - Cash equity prices
  - Government, interbank or FX implied interest rates

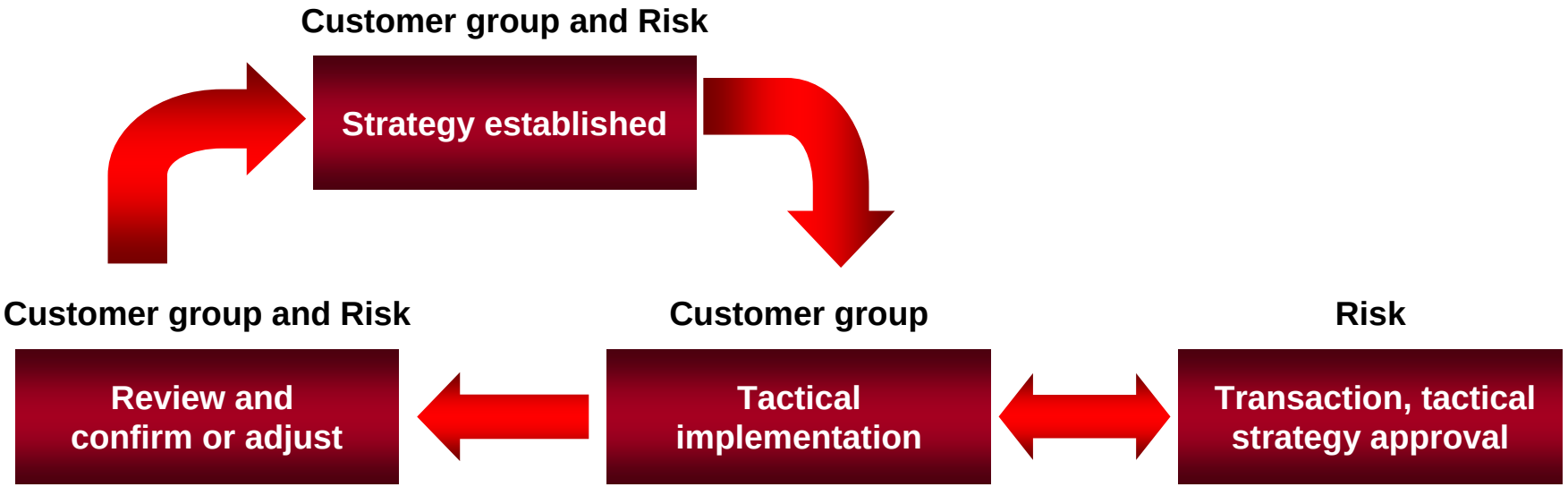
Other risk areas

Tangible	Less tangible
Insurance	Reputational
Pension	Sustainability
Liquidity	Compliance
	Fraud
	Operational

Risk management

- Clarity of ‘rules and requirements’
- Communication of relationship philosophy
- Strict adherence thereto
- Training and development programmes
- Staff rotation
- Identification, measurement and management of risk
- Risk is everyone’s business in HSBC

Portfolio growth



Determine appetite for Risk in partnership with customer groups; Risk has casting vote

Customer groups implement strategy independently

Regular review of outcome in partnership

Risk outlook

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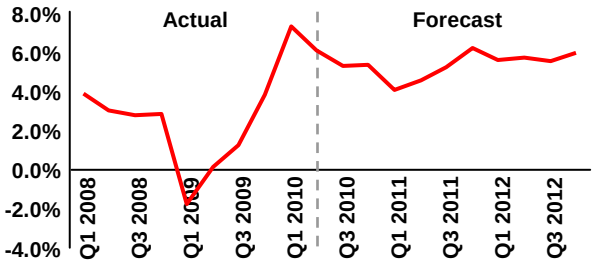
Leading indicators

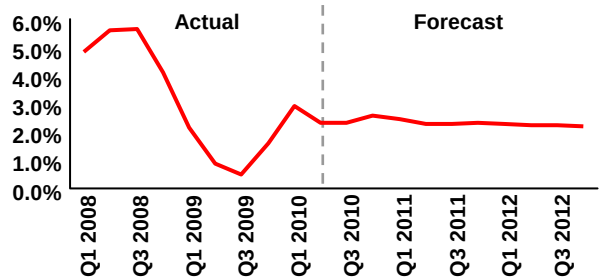
The future looks rosy



Source: Oxford Economics

Asia-Pacific GDP

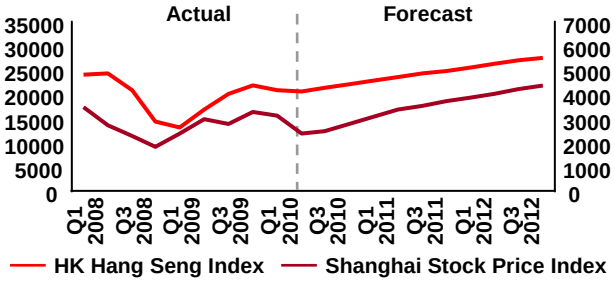
Stable with strong growth from 2011



Source: Oxford Economics

Asia-Pacific CPI

Inflation will be monitored and controlled by policy makers

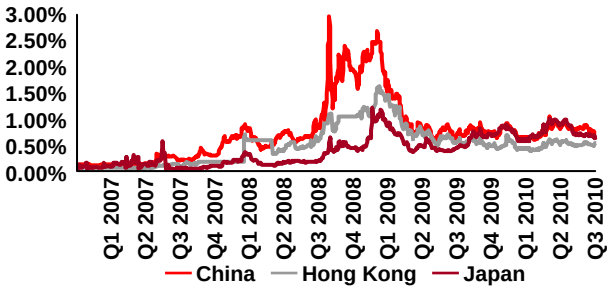


Source: Oxford Economics

China and HK equity

Equity market to rise steadily into 2012

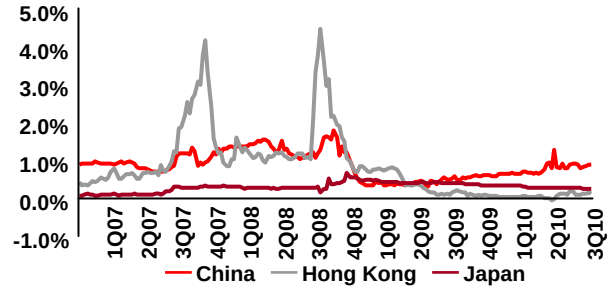
Caution!



Source: Bloomberg

CDS spread

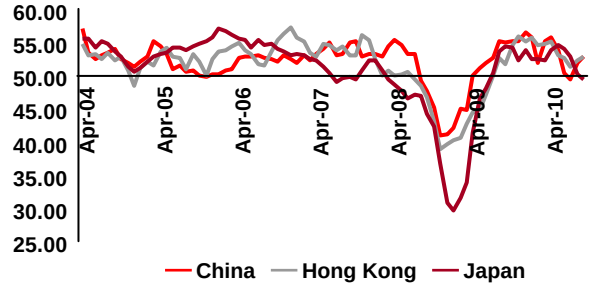
Sovereign risk stabilises across Asia-Pacific but remains higher than pre-crisis level



Source: Bloomberg

TED spread

Rising banking risk in China



Source: HSBC Global Research

Purchasing managers' index

Business confidence is volatile with Japan sliding

Loan impairment charges and non-performing loans

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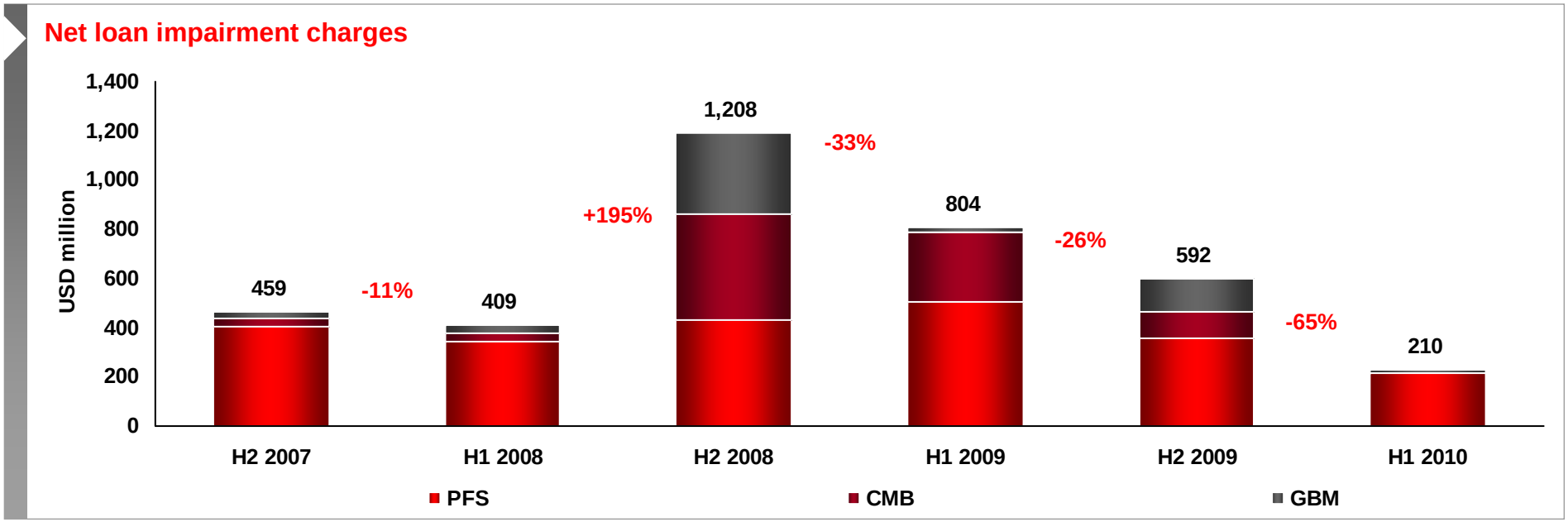
Loan impairment charges

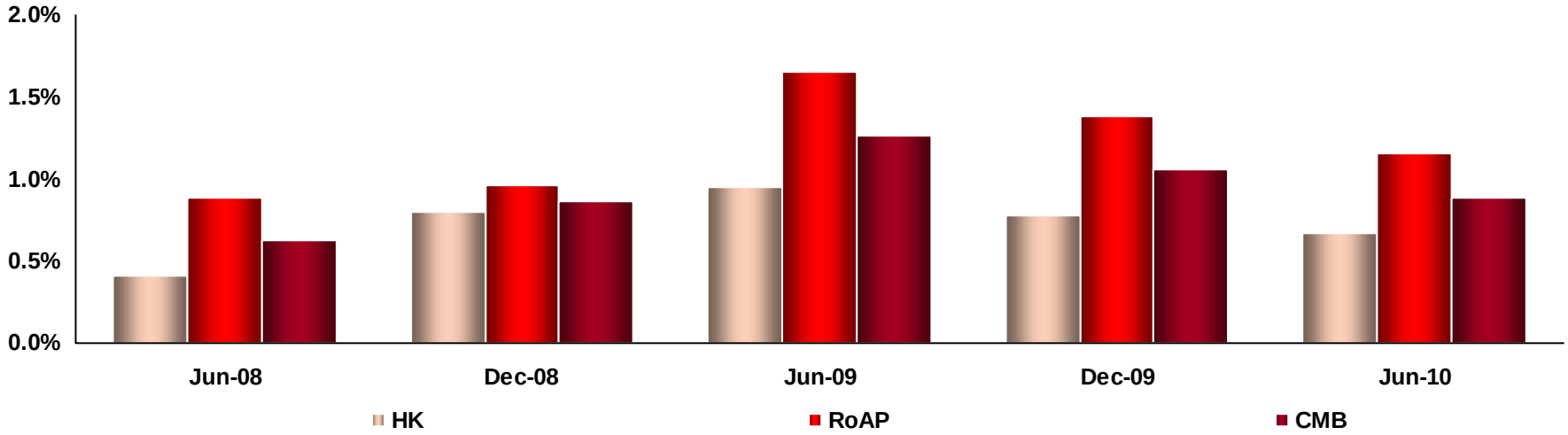


- A critical measurement in management of risk
- 'Normalisation' of portfolio quality
- Strength of portfolio through cycle
- Strength of function – use of leading indicators, especially account behavior

- Customers' internal fraud
- Over-extended business
- Strategies impacted by the global financial crisis
- Relationship bank: cannot simply pull the rug

Non-performing loans (NPL)

NPL as a per cent of total customer advances: comparison between Hong Kong, RoAP and CMB



NPL (USDm)	Jun-08	Dec-08	Jun-09	Dec-09	Jun-10
	1,283	1,687	2,325	2,041	1,960

- **Returning to our expectation as a relationship-driven commercial bank**
- **Impairment allowance coverage of NPL ratio: 88 per cent**
- **Many NPLs are collateralised**

- **Dynamic measurement of risk in the loan book**
- **Credit quality bottomed out in May 2010 and is now improving**
- **76 per cent of loan book is strong[1]**

Notes:
(1) 'Strong' exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Retail accounts operate within product parameters and only exceptionally show any period of delinquency.

Loan impairment charges and non-performing loans

- **The tree was shaken and bad apples fell**
- **Genuine business difficulties are identified early and we work towards rehabilitation or an orderly winding-up**
- **Systems-based risk identification**
- **Desk top sampling of accounts and portfolio**
- **Physical visits to countries and customers**

Loan impairment charges and non-performing loans

2010: What has changed

- Leading indicators
- Granularity of data – Basel II
- Disciplined Risk Appetite parameters – Basel II
- Stress Testing Framework – Basel II
- Increased industry regulation
- Less fraud attempts by customers

2010: What has not changed

- Relationship approach
- Long-term view
- Breadth of products and services
- Relationship management training
- Strong operational infrastructure and framework of procedures and processes
- The brand

Risk governance

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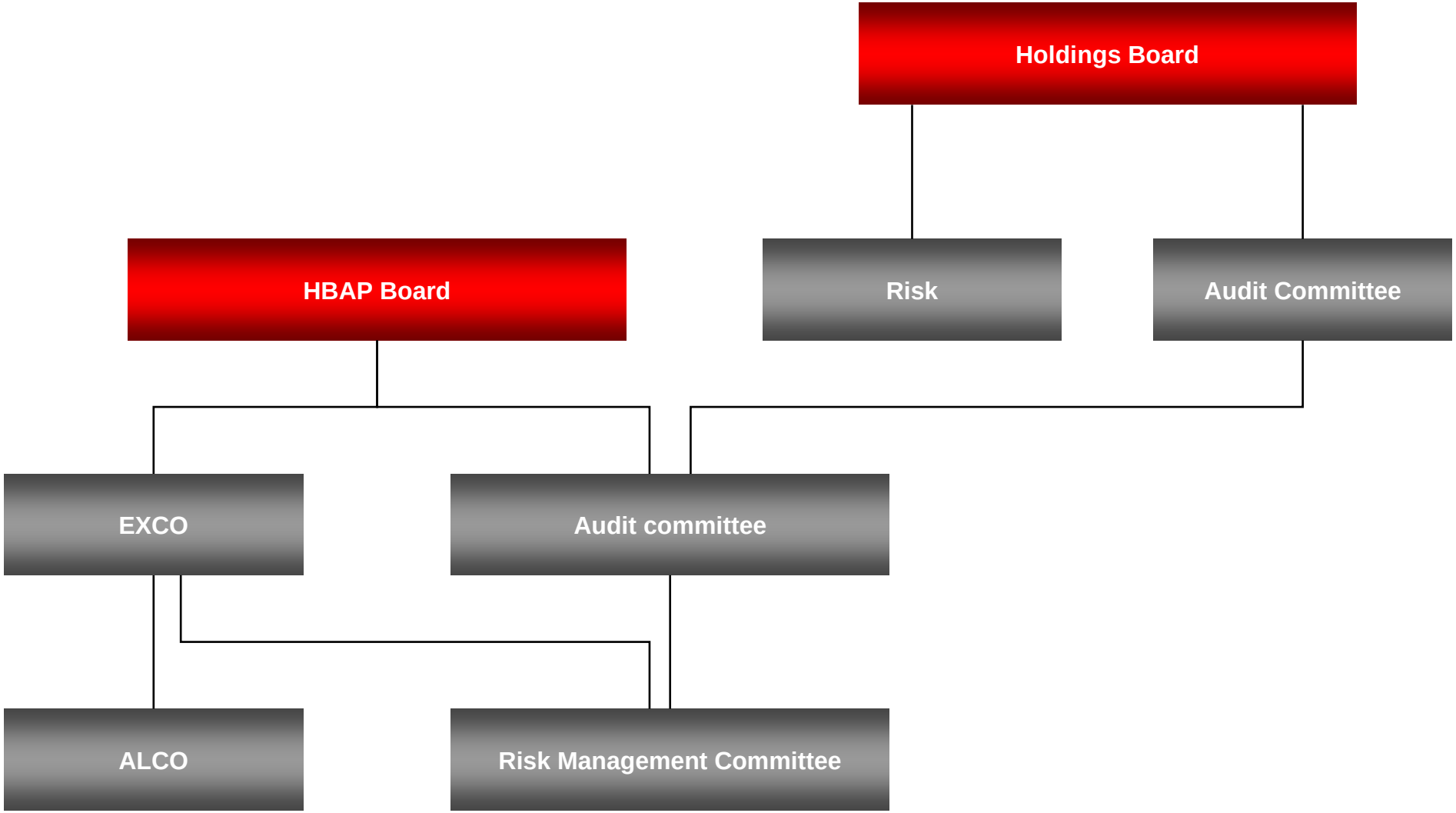
The objectives

“The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.’’

– The UK Corporate Governance Code (June 2010)

- **Governance structure**
- **Organisation structure**
- **Independence**
- **Escalation**
- **Reporting and informing**

Risk governance structure

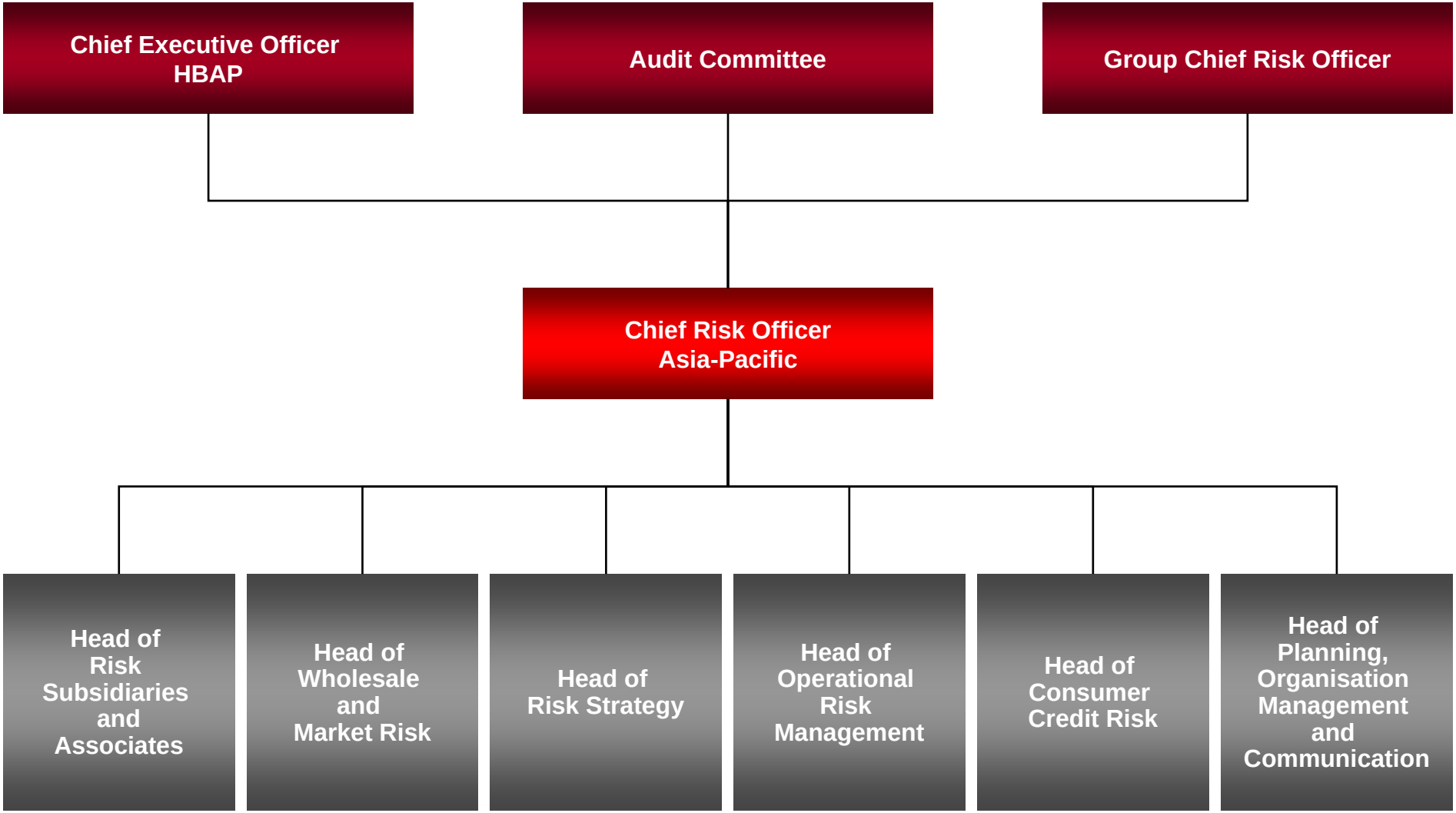


The transformation in risk management

Centralisation of all risk departments

Bottom up	Top down
Monitoring	Management
Support	Strategic

Organisation structure, independence, escalation



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In conclusion

- **Risk across all measures increased during H1 2010**
  - **In line with our objectives and expectations**
  - **Without compromising credit quality**
- **We continue to increase the sophistication of our risk management**
  - **Regular portfolio reviews and stress tests**
  - **Top down setting of Risk Appetite**
- **Risk maintains its independence**