

HSBC Holdings plc

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HSBC 
The world's local bank

Risk – Investor and Analyst Update



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 Annual Report and Accounts 2010. 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 are provided in the 'Reconciliation of reported and underlying profit before tax' supplement available at www.hsbc.com.**

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Changes & Developments in HSBC Risk



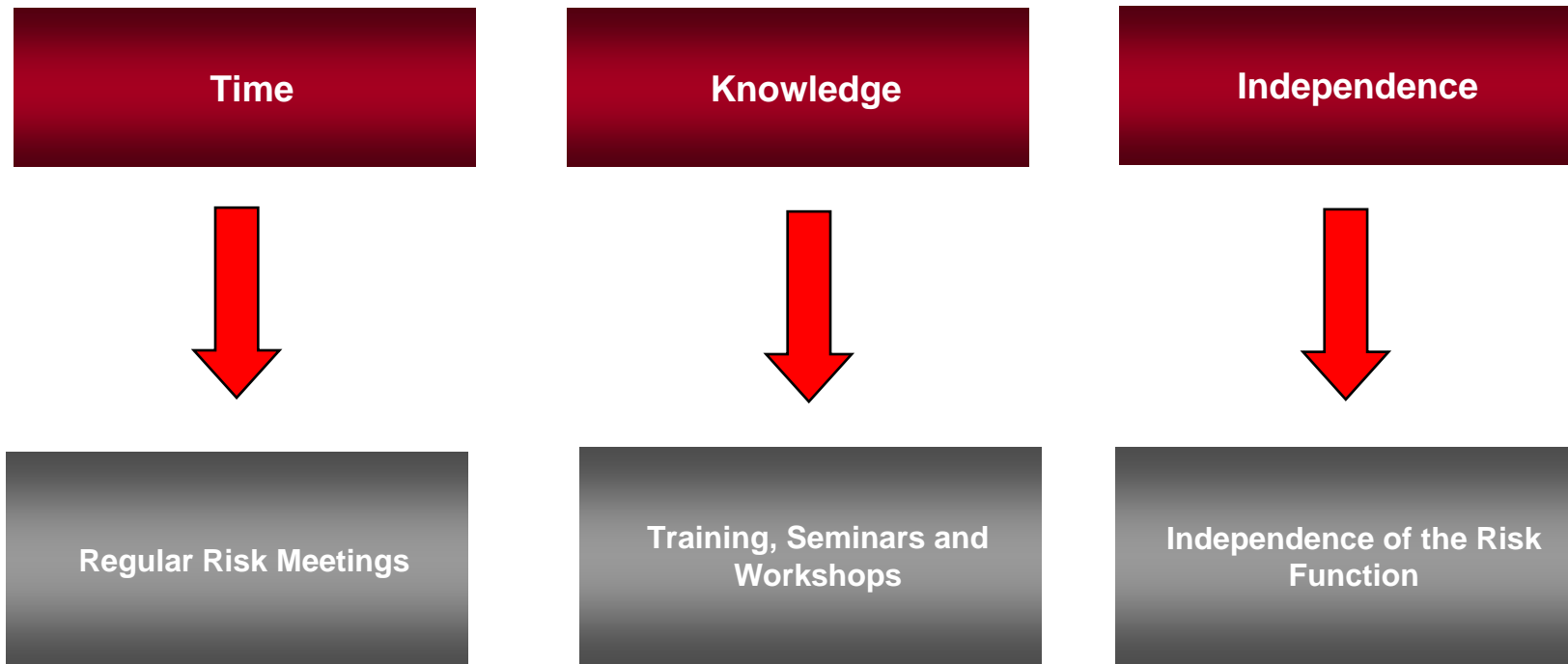
Managing risk in light of the financial crisis

- ▶ **Recent financial crisis highlighted the effectiveness of risk at HSBC**
- ▶ **HSBC did not require any financial assistance**
- ▶ **Responsible lending and focus on relationships – HSBC culture**
- ▶ **Deposit funded lending – core value of HSBC**
- ▶ **Risk Appetite – the driver for Risk Management**

HSBC has a conservative approach to Risk

- ▶ **Risk Appetite is the driver for Risk Management**
- ▶ **Dedicated Board level Audit & Risk Committee covering all aspects of risk**
- ▶ **CRO reports jointly to the CEO and to the Board level Audit & Risk Committee**
- ▶ **Clarity of 'rules and requirements'**
- ▶ **Communication of relationship philosophy**
- ▶ **Training and development programmes**
- ▶ **Staff rotation**
- ▶ **Identification, measurement and management of risk**
- ▶ **Risk is everyone's business in HSBC**

Effective Board Oversight of Risk at HSBC



HSBC Risk Best Practices

▶ Risk Appetite

- Credit
- Market
- Operational
- Earnings
- Liquidity
- Insurance/Pension
- Reputational
- Earnings
- Capital

▶ Strong Governance

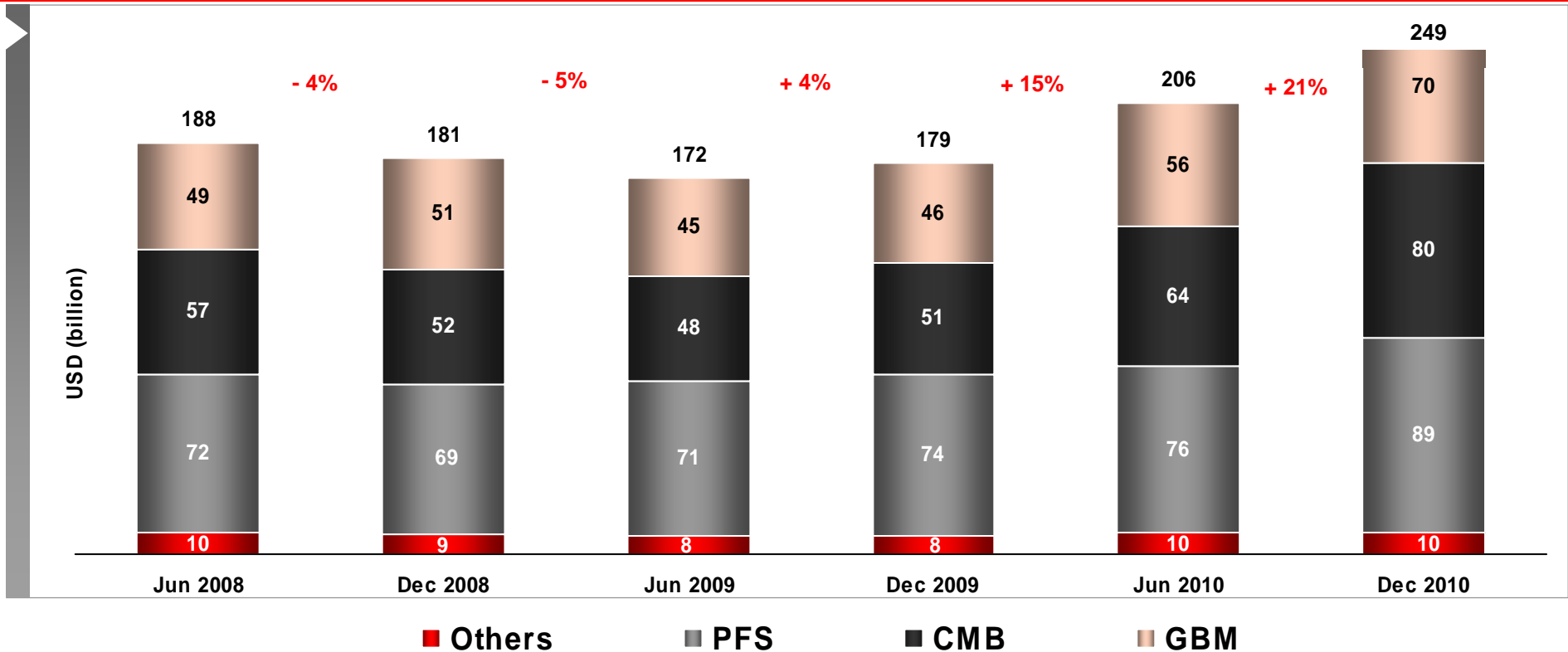
- ▶ The Risk Management Committee pack consists of top and emerging risks, giving the Risk function a forward looking view to support business.
- ▶ All sites have a dedicated CRO who:
 - is a member of the Executive Committee
 - reports to the CEO, Regional CRO and to the Board when such exists

- ▶ **Strong Incentives** – ASP Chief Risk Officer approves all incentive schemes and provides material input into values and behaviours assessments

Risk Portfolios



Net Customer advances



Concentration

- ▶ Well-balanced across customer groups
- ▶ Well-balanced and diversified across industry sectors
- ▶ No geographic concentration concerns
- ▶ Focus on growth outside Hong Kong

Credit Quality

- ▶ LICs as % of customer advances down from 0.73% (Dec 09) to 0.23% (Dec 10)
- ▶ Loan growth of 39% in 2010 compared to Credit Risk RWAs growth of 11%

Managing the Commercial Surplus

- ▶ **Adhere to disciplined investment framework**
- ▶ **Security of customer deposits is paramount**
- ▶ **Central management of:**
 - ▶ **Interest rate risk**
 - ▶ **Currency risk**
 - ▶ **Tenor risk**

Management of Market Risks

▶ **Philosophy and approach to market risk**

- Manage and control market risk exposures in order to optimise return on risk
- Limits are set for portfolios, products and risk types
- Independent market risk management and control function
- Measurement: Sensitivity analysis, VaR and Stress testing

▶ **Nature of risks that we are running**

- Foreign exchange rate risk
- Commodity price risk
- Interest rate risk
- Credit spread Risk
- Equity price Risk

▶ **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

Portfolio growth

Customer group & Risk

Strategy established

Customer group & Risk

Review and
confirm or adjust

Customer group

Tactical
implementation

Risk

Transaction, tactical
strategy approval

Determine appetite for Risk in
partnership with Customer groups.
Risk has casting vote.

Customer groups implement
strategy independently

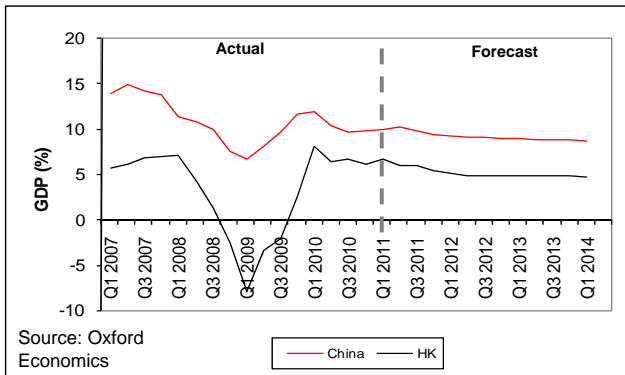
Regular review of outcome in
partnership

Risk Outlook



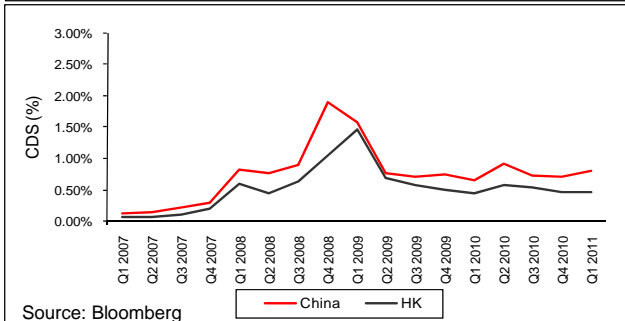
Leading indicators

Outlook is Positive



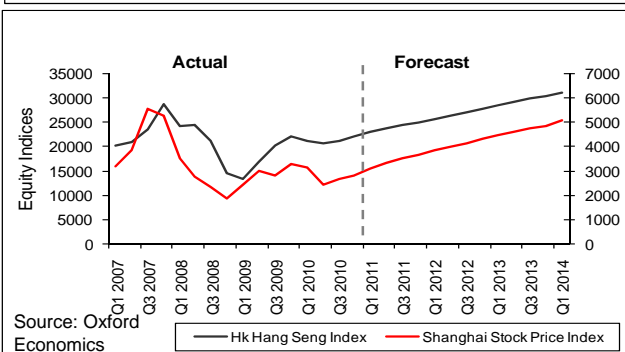
Asia-Pacific GDP

Strong output maintained but growth rates to slow moderately



CDS Spread

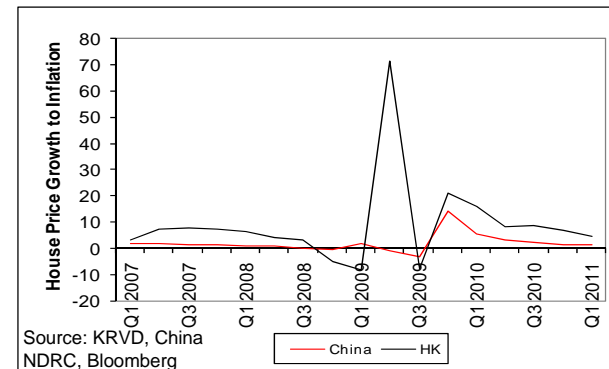
Sovereign risks remain stable and below crisis levels



China & HK equity

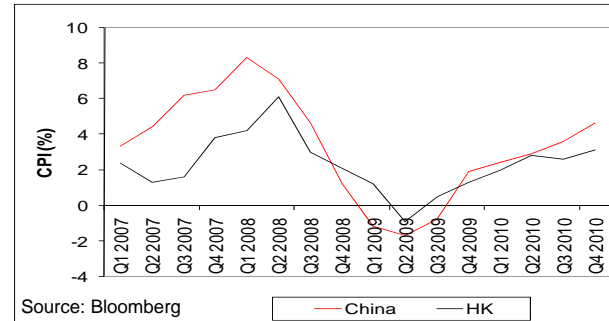
Equity markets forecast to rise steadily

Current Trends



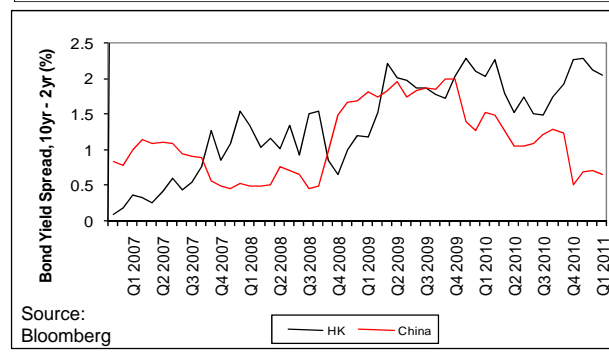
Property Price

House price growth cooled but still above inflation



Asia Pacific CPI

China's Inflation still above long term target of 4%, implies more tightening to come



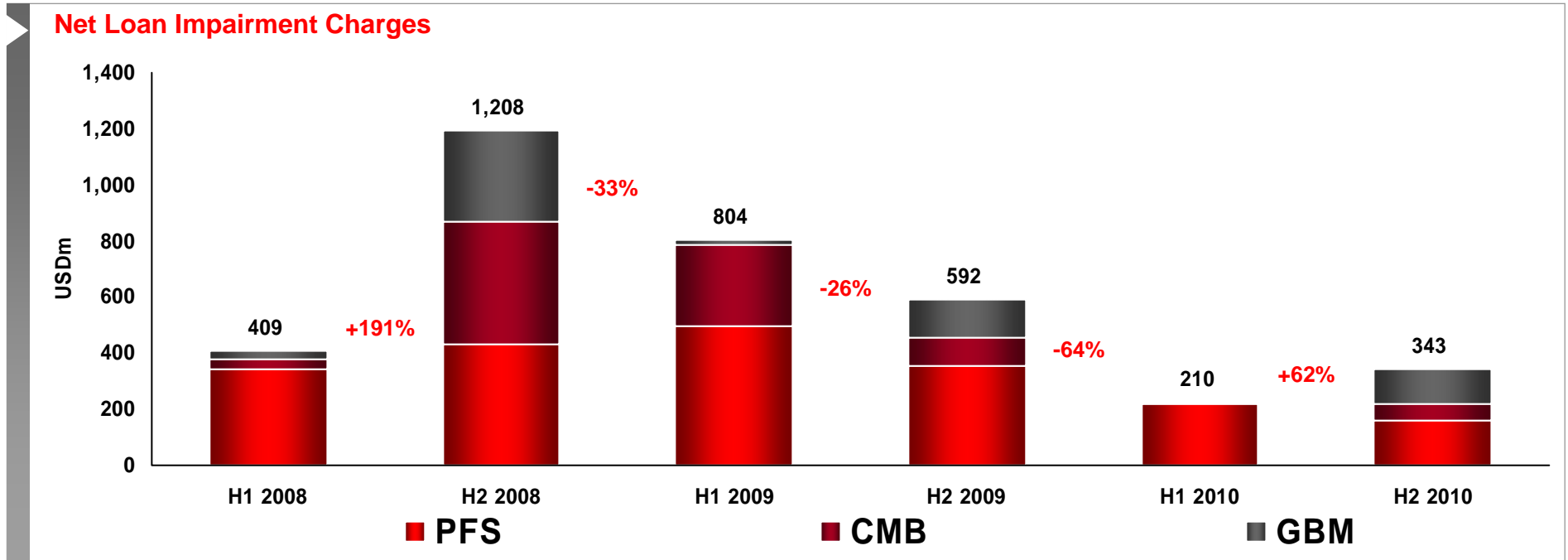
Interest Rate

Yield spreads imply possible rise in interest rates

Loan Impairment Charges & Impaired Advances



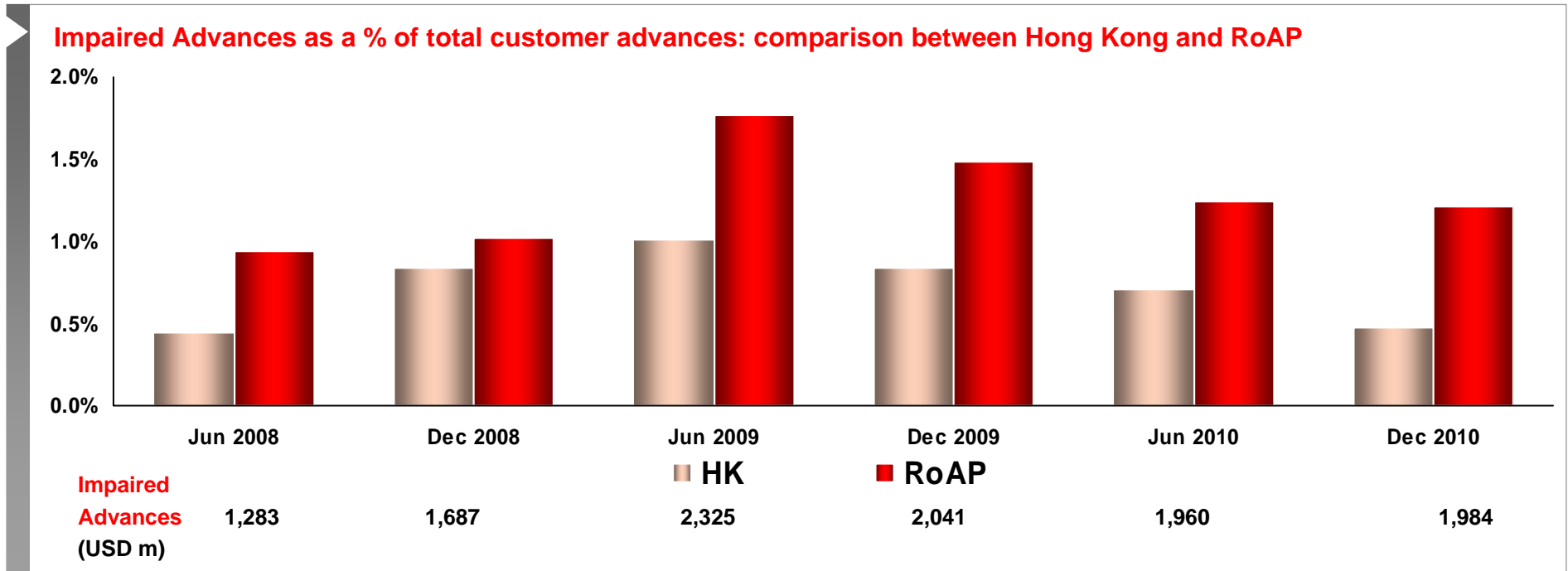
Loan Impairment Charges



- ▶ 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 behaviour

- ▶ Strategies impacted by the global financial crisis
- ▶ Gross Recoveries increased 37% from USD166m in 2009 to USD227m in 2010

Impaired Advances (IA)



▶ Relationship-driven commercial bank

▶ Dynamic measurement of risk in the loan book

▶ Impairment allowance coverage of Impaired Advances: 80%

Loan Impairment Charges & Impaired Advances

- ▶ **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 & Impaired Advances

2011: What has changed

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

2011: 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



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

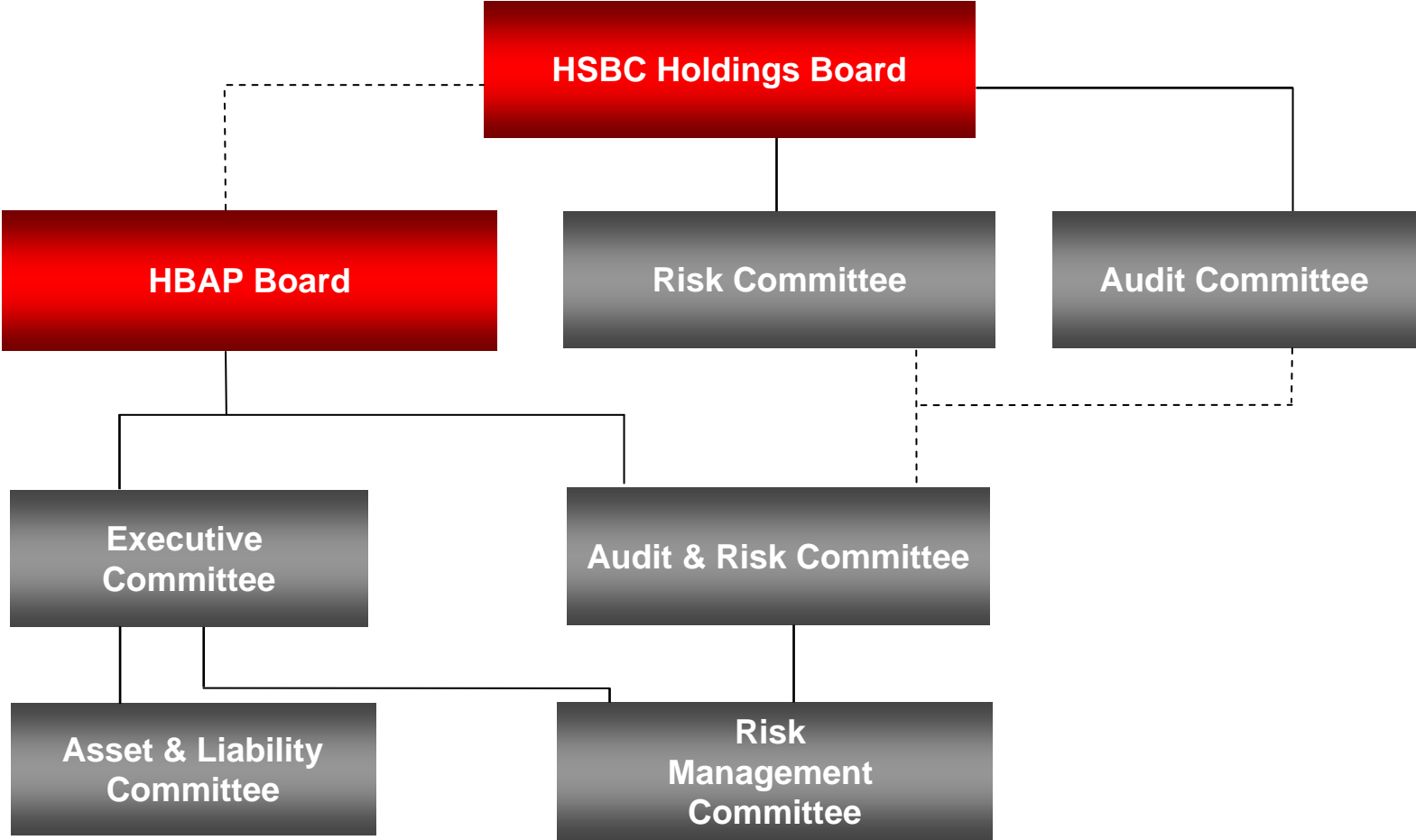
Organisation structure

Independence

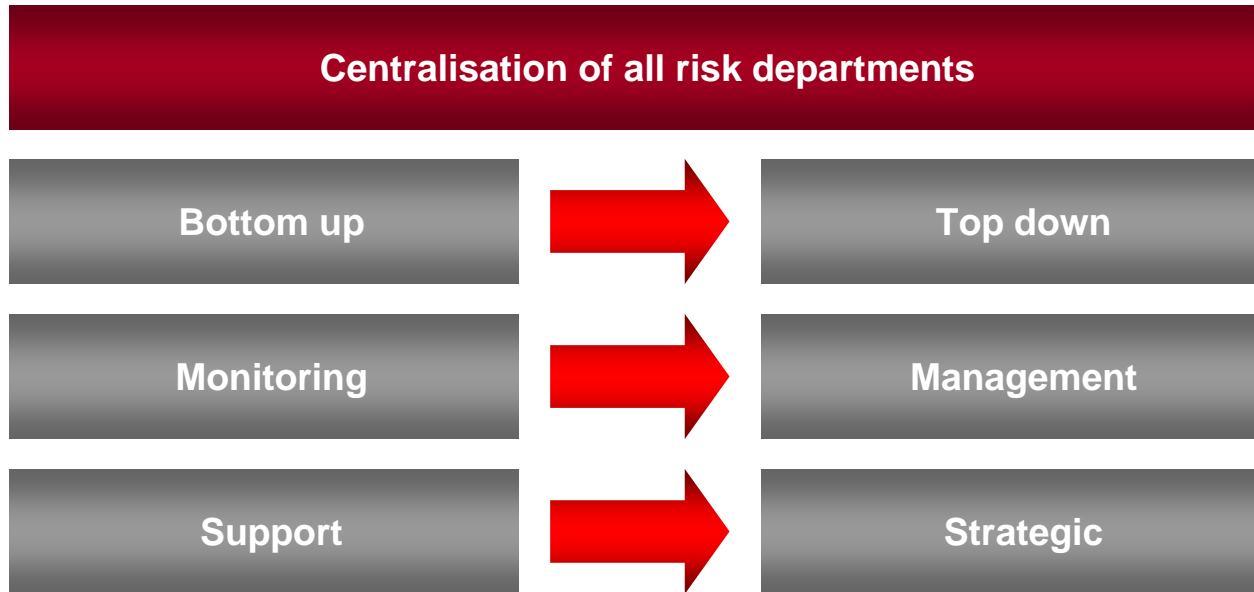
Escalation

Reporting and informing

New Risk Governance structure



The transformation in risk management



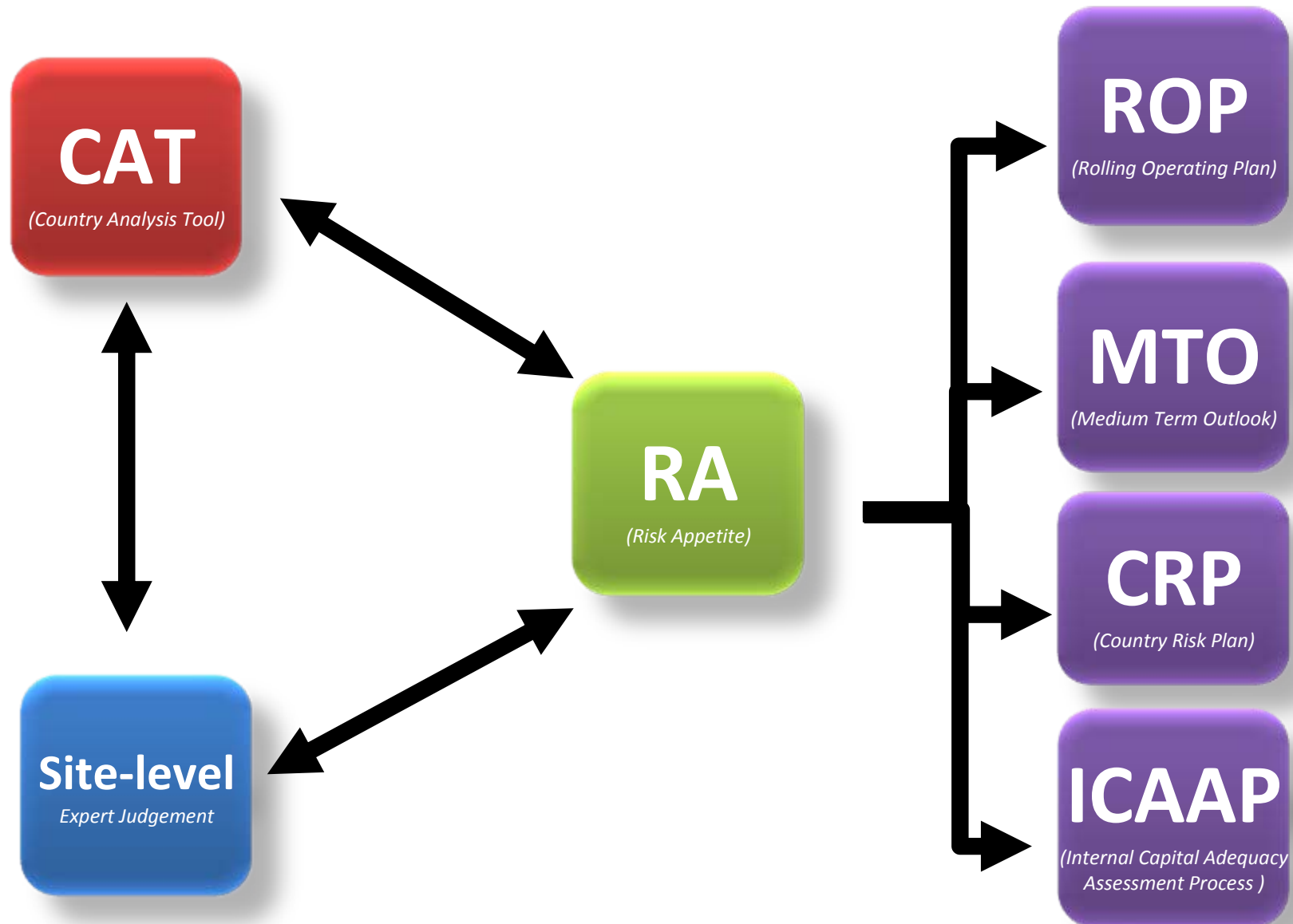
Organization structure, independence, escalation



Risk Appetite



Risk Appetite's Relevance to Business



In Conclusion

- ▶ **A critical part of strong Risk Governance is the determination of a formal Risk Appetite statement**
- ▶ **HSBC has implemented both a 'best in class' governance structure and has cascaded down to individual countries a formal Risk Appetite statement**
- ▶ **Risk's participation across all areas increased during 2010**
 - ▶ **In line with our objectives and expectations**
 - ▶ **Without compromising on our independence or 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**

Investor Relations

If you have any further questions please visit the Investor Relations website:

<http://www.hsbc.com/1/2/investor-relations>

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