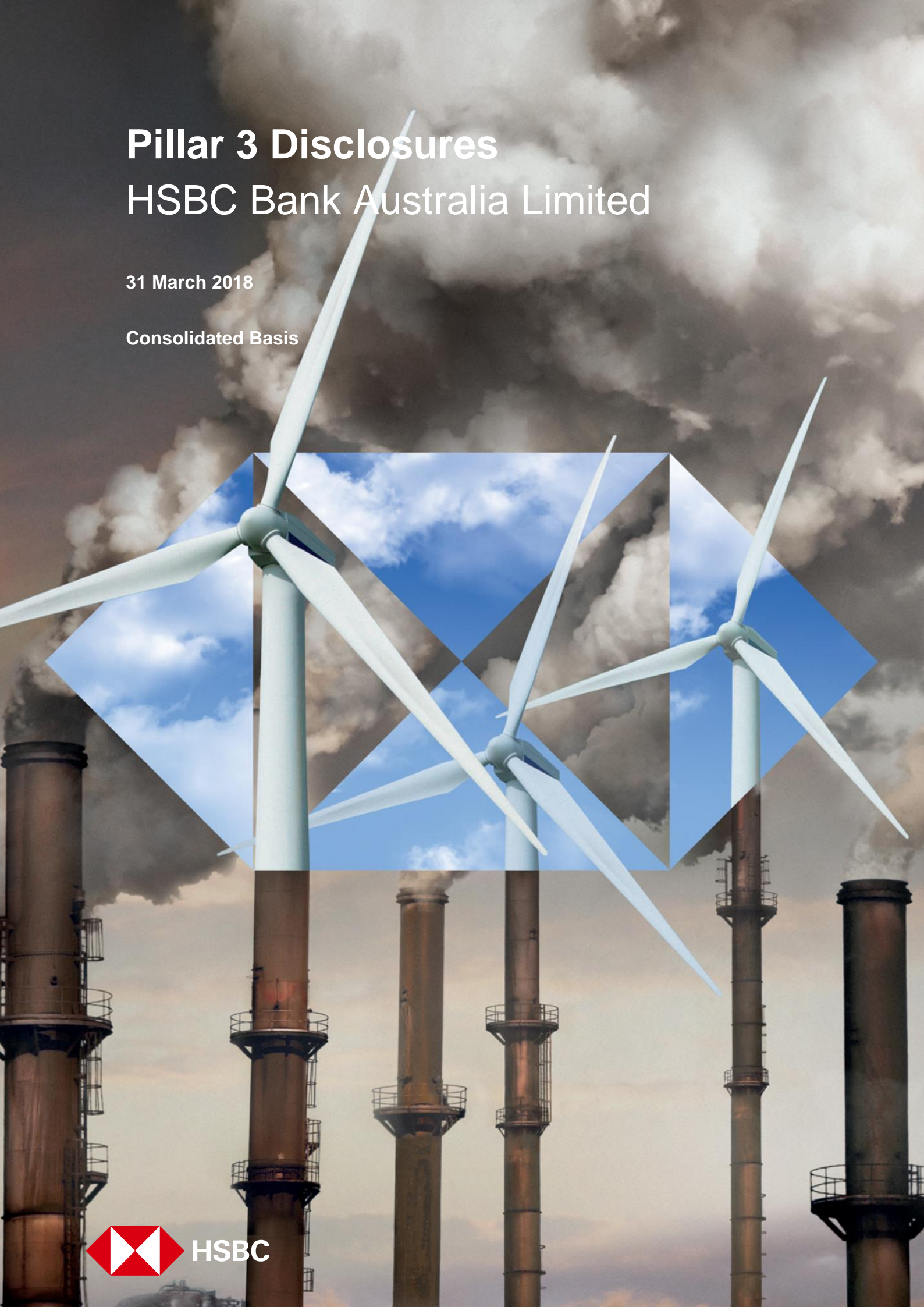


# Pillar 3 Disclosures

## HSBC Bank Australia Limited

31 March 2018

Consolidated Basis



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## 1. Introduction

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### Purpose

The Basel 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 which allow market participants to assess the scope of application by banks of the Basel 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.

### Background

Capital is a cornerstone of an Authorised Deposit-taking Institution's (ADI) strength. It provides a buffer to absorb unanticipated losses from an ADI's activities and, in the event of unforeseen events, enables the ADI to continue operating while those issues are addressed or resolved. In June 2004, the Basel Committee on Banking Supervision (BCBS) introduced a new capital adequacy framework to replace the 1988 Basel Capital Accord in the form of a new Accord (commonly known as 'Basel II'). This was followed in December 2010 by 'Basel III', a comprehensive set of reform measures, developed by the BCBS, to strengthen the regulation, supervision and risk management of the banking sector. These measures aim to:

- improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source;
- improve risk management and governance; and
- strengthen banks' transparency and disclosures.

The capital adequacy framework under the Basel regime, implemented since 1 January 2008 in Australia, seeks to promote regulatory capital requirements that are more comprehensive and sensitive to risk and therefore, more aligned to the risk appetites of individual banks.

The supervisory objectives of Basel are to promote safety and soundness in the financial system and maintain an appropriate level of capital in the system, enhance competitive equality, and establish a more comprehensive approach to addressing risks. The application of Pillar 3 aims to enhance transparency in Australian financial markets by setting minimum requirements for the public disclosure of information on the capital adequacy of locally incorporated ADIs.

As outlined in Australian Prudential Standard APS 330, the Australian Prudential Regulation Authority (APRA) has adopted a proportional approach to Pillar 3 to ensure disclosure of information by banks is appropriate to the nature, scope and complexity of their activities, distinguishing clearly between banks adopting the Basel Advanced Approaches and those adopting the Standardised Approach.

Basel III capital reforms took effect from 1 January 2013 and are designed to further strengthen capital requirements with the aim of promoting a more resilient banking sector and its ability to absorb severe losses. Existing capital instruments which did not meet the new Basel III capital eligibility criteria as detailed in Prudential Standard APS 111 were de-recognised from 1st January 2013 or formally approved by APRA to allow the application of transitional arrangements.

To view the main features of the current regulatory capital instruments please refer to the Regulatory Disclosures tab using the following link:

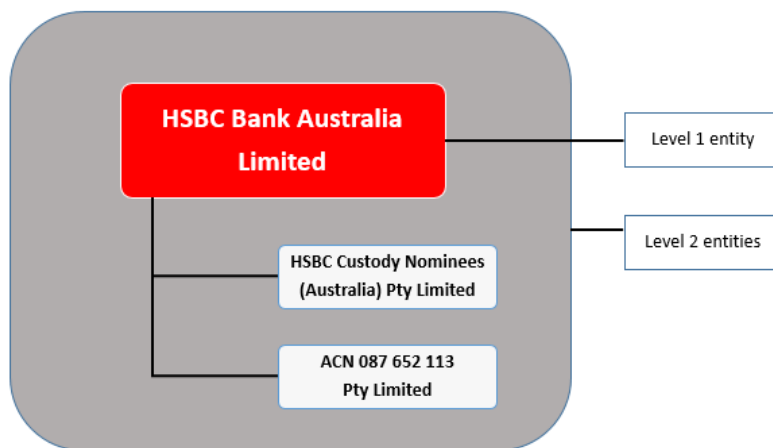
<http://www.about.hsbc.com.au/hsbc-in-australia>

## 2. Scope of Application

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For regulatory (APRA) reporting purposes, HSBC Bank Australia Limited (HBAU) establishes two levels of reporting; Level one, which is HSBC Bank Australia Limited only, and Level two, which is the consolidation of HSBC Bank Australia Limited and all its financial subsidiaries.

The Pillar 3 disclosures are based on Level 2 - Consolidated basis.



## 3. Verification

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The Pillar 3 disclosures have been appropriately verified internally and are consistent with information that has been subject to review by an external auditor and that is lodged or published elsewhere or that has been already supplied to APRA.

## Basel III Pillar 3 Disclosures – as at 31 March 2018

### 4. HBAU Context

HSBC is one of the world's largest banking and financial services organisations and therefore deals with multiple regulators in multiple jurisdictions around the world. HSBC Holdings plc, regulated by the Prudential Regulation Authority (PRA) in the UK, operates under the Advanced Internal Ratings Based Approach (IRB-A) for the majority of its Credit Risk, the Standardised Approach for Operational Risk and a mix of the Internal Models Approach and the Standardised Approach for Market Risk (since 1 January 2008).

The Hongkong and Shanghai Banking Corporation Limited (HBAP), regulated by the Hong Kong Monetary Authority (HKMA) in Hong Kong, has adopted the IRB-A approach for Credit Risk, the Standardised approach for Operational Risk and both the Internal Models and Standardised approach for Market Risk as of 1 January 2009.

HBAU has adopted the APRA Standardised approach to Credit, Market and Operational Risks as of 1 January 2008.

Regulator	Institution	Credit risk	Operational risk	Market risk
APRA	HBAU	STD	STD (ASA)	STD
HKMA	HBAP	IRB-A	STD	IMA/STD
PRA	HSBC Holdings plc	IRB-A	STD	IMA/STD

- IRB-A = Internal Ratings Based – Advanced Approach for Credit Risk  
 IMA = Internal Models Approach for Market Risk  
 STD = Standardised Approach for either Credit, Market or Operational Risk  
 STD (ASA) = Standardised Approach (Alternative Standardised Approach) for Operational Risk

### 5. Frequency

This report will be released on a quarterly basis, comprising Capital Adequacy disclosures (Table 3) and Credit Risk and Securitisation Exposures (Tables 4 and 5).

The Regulatory Capital Composition and Reconciliation (Table 1) and Remuneration disclosures (Table 18) are published annually as at the 31<sup>st</sup> December balance sheet date and can be viewed on the HSBC website under 'Regulatory disclosures' tab using the following link:

<http://www.about.hsbc.com.au/hsbc-in-australia>

### 6. Enquiries

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## 7. Risk Definitions

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### **Credit risk**

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 and trade finance, but also from off-balance sheet exposures such as market and non-market related transactions, and from HBAU's holdings of debt securities. Among the risks HBAU engages in, credit risk generates the largest regulatory capital requirement.

### **Market risk**

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 HBAU's income or the value of its portfolios. HBAU separates exposures to market risk into trading and non-trading portfolios. Trading portfolios include those positions arising from market-making, proprietary position-taking and other marked-to-market positions so designated. Non-trading portfolios primarily arise from the interest rate management of HBAU's retail and commercial banking assets and liabilities and financial investments classified as available-for-sale and held-to-maturity.

### **Operational risk**

Operational risk is the risk of loss arising through fraud, unauthorised activities, errors, omissions, inefficiencies, systems failures or from external events. It is inherent in every business organization and covers a wide spectrum of issues. The terms error, omission and inefficiency include process failures, systems/machine failures and human error.

## Basel III Pillar 3 Disclosures – as at 31 March 2018

**Table 3 - Capital Adequacy (Consolidated)**

All figures in AUDm

<b>Capital requirements (in terms of risk weighted assets) for Credit risk by portfolio</b>	<b>March 2018</b>	<b>December 2017</b>
<ul style="list-style-type: none"> <li>• Corporate</li> <li>• Government</li> <li>• Bank</li> <li>• Residential Mortgage</li> <li>• Other Retail</li> <li>• All Other</li> </ul>	6,900.8 - 588.1 6,559.4 980.3 74.3	6,938.0 - 630.6 6,350.7 1,002.9 65.5
<b>Risk weighted assets – Credit risk excluding securitisation</b>	<b>15,102.9</b>	<b>14,987.7</b>
<ul style="list-style-type: none"> <li>• Securitisation</li> </ul>	-	-
<b>Total Credit risk weighted assets</b>	<b>15,102.9</b>	<b>14,987.7</b>
Capital requirements (in terms of risk weighted assets) for Market risk	37.9	38.5
Capital requirements (in terms of risk weighted assets) for Operational risk	1,923.7	1,923.7
<b>Total risk weighted assets</b>	<b>17,064.5</b>	<b>16,949.9</b>

<b>Capital Ratios (for the consolidated banking group)</b>	<b>March 2018</b>	<b>December 2017</b>
Common Equity Tier 1 capital ratio	10.2%	10.4%
Tier 1 capital ratio	11.7%	11.9%
Total capital ratio	13.7%	13.9%

## 8. Credit Risk Management

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The role of an independent credit control unit is fulfilled by the Global Risk function. Credit approval authorities are delegated by the Board to certain executive officers of HSBC Holdings PLC. Similar credit approval authorities are delegated by the Boards of subsidiary companies to executive officers of the relevant subsidiaries. In each major subsidiary, a Chief Risk Officer reports to the local Chief Executive Officer on credit-related issues, while maintaining a direct functional reporting line to the Group Chief Risk Officer in Global Risk. Details of the roles and responsibilities of the credit risk management function and the policies and procedures for managing credit risk are set out below. The high-level oversight and management of credit risk is provided globally by the Credit Risk function in Global Risk:

- to formulate Group credit policy. Compliance, subject to approved dispensations, is mandatory for all operating companies which must develop local credit policies consistent with Group policies;
- to guide operating companies on our appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain higher-risk sectors;
- to undertake an independent review and objective assessment of risk. Global Risk assesses all commercial non-bank credit facilities and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken;
- to monitor the performance and management of portfolios across the Group;
- to control exposure to sovereign entities, banks and other financial institutions, as well as debt securities which are not held solely for the purpose of trading;
- to set Group policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to our capital base, and remain within internal and regulatory limits;
- to control our cross-border exposures;
- to maintain and develop our risk rating framework and systems, the governance of which is under the general oversight of the Group Model Oversight Committee ('MOC'). The Group MOC meets bi-monthly and reports to the Risk Management Meeting. It is chaired by the risk function and its membership is drawn from Global Risk and global businesses;
- to report to the Risk Management Meeting, the Group Risk Committee and the Board on high risk portfolios, risk concentrations, country limits and cross-border exposures, large impaired accounts, impairment allowances, stress testing results and recommendations and retail portfolio performance; and
- to act on behalf of HSBC Holdings as the primary interface, for credit-related issues, with the Bank of England, the PRA, local regulators, rating agencies, analysts and counterparts in major banks and non-bank financial institutions.

HSBC's consolidated entity operating in Australia is required to implement credit policies, procedures and lending guidelines which conform to HSBC Group standards, with credit approval authorities delegated from the Board of Directors of the consolidated entity to the Chief Executive Officer. The management of the consolidated entity includes a Chief Risk Officer who reports to the local Chief Executive Officer on credit related issues and has a functional reporting line to the HBAP Chief Risk Officer for the Asia Pacific Region. The consolidated entity is responsible for the quality and performance of its credit portfolios and for monitoring and controlling all credit risks in its portfolios, including those subject to central approval by global risk management. This includes managing its own risk concentrations by market sector, geography and product. Local systems are in place to enable the consolidated entity to control and monitor exposures by customer and retail product segments.



**Table 4(A) – Credit Risk by Gross Credit Exposure (Consolidated)**

All figures in AUDm

Exposure Type	March 2018		December 2017	
	Total gross Credit risk exposures	Average gross exposure over the period	Total gross Credit risk exposures	Average gross exposure over the period
• Cash and Liquid Assets	252.3	153.3	54.3	76.3
• Debt Securities	8,104.9	7,691.7	7,278.5	7,536.0
• Due from Other Financial Institutions	1,934.0	1,782.0	1,630.0	1,646.1
• Loans and Advances	22,632.3	22,552.8	22,473.3	22,083.7
• Derivatives	196.8	206.0	215.1	197.6
• Contingent Liabilities, Commitments and other Off-Balance Sheet Exposures	7,038.1	7,010.2	6,982.2	7,161.4
• Other Assets	187.1	187.0	186.8	191.1
<b>Total Exposures</b>	<b>40,345.5</b>	<b>39,583.0</b>	<b>38,820.2</b>	<b>38,892.2</b>
Portfolio Type	Total gross credit risk exposures	Average gross exposure over the period	Total gross credit risk exposures	Average gross exposure over the period
• Corporate	8,609.8	8,712.1	8,814.3	8,835.1
• Government	6,033.5	5,619.0	5,204.4	5,444.5
• Bank	6,175.7	6,072.9	5,970.1	6,208.3
• Residential Mortgage	18,459.8	18,096.0	17,732.1	17,317.9
• Other Retail	1,000.8	1,015.6	1,030.4	1,024.0
• All Other	65.9	67.4	68.9	62.4
<b>Total Exposures</b>	<b>40,345.5</b>	<b>39,583.0</b>	<b>38,820.2</b>	<b>38,892.2</b>

**Note:** Total exposures are based on local APRA definitions.

**Table 4(B) – Credit risk (Consolidated)**

All figures in AUDm

**Financial Position**

	<b>March 2018</b>			
Portfolios subject to Standardised approach	Impaired Loans	Restructured Loans	Past due loans >90 days <sup>1</sup>	Provision <sup>2</sup>
• Corporate	83.9	27.5	-	71.6
• Government	-	-	-	-
• Bank	18.5	-	-	16.5
• Residential Mortgage	35.3	2.6	50.5	7.5
• Other Retail	0.1	12.0	34.6	77.5
• All Other	-	-	-	-
<b>Sub Total</b>	<b>137.8</b>	<b>42.1</b>	<b>85.1</b>	<b>173.1</b>
<b>Total Provisions</b>				<b>173.1</b>
	<b>December 2017</b>			
Portfolios subject to Standardised approach	Impaired Loans	Restructured Loans	Past due loans >90 days <sup>2 1</sup>	Provision <sup>2</sup>
• Corporate	47.9	30.0	-	49.1
• Government	-	-	-	-
• Bank	18.2	-	-	16.2
• Residential Mortgage	19.9	2.8	69.5	1.1
• Other Retail	0.1	10.1	32.0	25.4
• All Other	-	-	-	-
<b>Sub Total</b>	<b>86.1</b>	<b>42.9</b>	<b>101.5</b>	<b>91.9</b>
Collective provision				12.3
<b>Total Provisions</b>				<b>104.2</b>

<sup>1</sup> Includes Individually and Portfolio Managed Facilities.

<sup>2</sup> HBAU implemented AASB9: 'Financial Instruments' (AASB9) on 1 January 2018. AASB 9 requires a different provisioning methodology to the previous accounting standard, and therefore March 2018 and December 2017 provisions are not directly comparable. The impairment requirements under AASB 9 are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. An increase of AUD69.7m in provisions was recognised on transition to AASB9.

## Basel III Pillar 3 Disclosures – as at 31 March 2018

**Table 4(B) – Credit risk (Cont.)**

All figures in AUDm

**Financial Performance**

Portfolios subject to Standardised approach <sup>1</sup>	March 2018			
	Charges for Provisions	Write offs	Recoveries	Total
• Corporate	7.2	-	(8.1)	(0.9)
• Government	-	-	-	-
• Bank	0.1	-	-	0.1
• Residential Mortgage	1.3	-	(0.6)	0.7
• Other Retail	9.5	10.6	(9.6)	10.5
• All Other	-	-	-	-
<b>Sub Total</b>	<b>18.1</b>	<b>10.6</b>	<b>(18.3)</b>	<b>10.4</b>
<b>Total loan impairment charges and other movement in credit risk provisions</b>	<b>18.1</b>	<b>10.6</b>	<b>(18.3)</b>	<b>10.4</b>

<sup>1</sup> Year-to-Date figures excluding the impact of the transition to AASB 9.

Portfolios subject to Standardised approach <sup>2</sup>	December 2017			
	Charges for Provisions	Write offs	Recoveries	Total
• Corporate	8.2	-	(1.5)	6.6
• Government	-	-	-	-
• Bank	-	-	-	-
• Residential Mortgage	1.9	-	(2.4)	(0.5)
• Other Retail	7.4	41.5	(14.1)	34.8
• All Other	-	-	-	-
<b>Sub Total</b>	<b>17.5</b>	<b>41.5</b>	<b>(18.0)</b>	<b>41.0</b>
Movement in collective provision ( not included above)	-	-	(7.1)	(7.1)
<b>Total loan impairment charges and other movement in credit risk provisions</b>	<b>17.5</b>	<b>41.5</b>	<b>(25.1)</b>	<b>33.9</b>

<sup>2</sup> Full year figures.

### Table 4 (C) – General Reserve for Credit Losses (GRCL)

The GRCL represents a reserve created against the possibility of future credit losses (currently unidentified) prudently estimated but not certain to arise over the full life of all the individual facilities making up the business of HSBC Bank Australia Ltd.

As outlined above, HBAU implemented AASB9 from 1 January 2018. The change in accounting provisioning methodology also has implications for the calculation of GRCL with APRA providing guidance on the allocation of the AASB 9 Expected Credit Losses by stage between regulatory specific provisions and GRCL.

For regulatory capital purposes, the difference between the GRCL and any accounting provisions deemed not to be regulatory specific provisions (the GRCL Shortfall) (net of tax) is deducted from Common Equity Tier 1 capital.

The General Reserve for Credit Losses is included in Tier 2 Capital.

All figures in AUDm

	<b>March 2018</b>	<b>December 2017</b>
<b>General Reserve for Credit Losses</b>	<b>96.4</b>	<b>102.4</b>

## 10. Securitisation

HBAU undertakes the following securitisation related activity in the normal course of business:

- securitisations of own originated residential mortgages for funding, contingent liquidity and potentially capital relief purposes. Such activity can potentially result in investment in any class of notes issued by the securitisation special purpose entity (SPE), provision of swaps to the SPE, provision of liquidity facilities and provision of Servicer and Trust Manager services to the SPE;
- securitisation is examined as part of the wider funding planning of the Bank and within the context of the HSBC Group's limited appetite for wholesale funding; and
- provision of interest rate swaps to third party securitisations.

HBAU does not invest in notes issued by third party securitisations in either Trading or Balance Sheet Management books.

### Table 5 – Securitisation Exposures

No new securitisation or re-securitisation activity was undertaken during the March 2018 or December 2017 quarters relating to SPEs where the notes and receivables are owned by external parties.

There were no new on-balance sheet securitisation exposures retained or purchased during March 2018 or December 2017 quarters. This excludes originated securitisation exposures for contingent liquidity purposes where no capital relief is sought. In such instance loans are retained for regulatory capital and risk weighted in accordance to APS 112. HSBC Bank Australia Limited has no re-securitisation exposure currently or in the prior quarter.

All figures in AUDm

	March 2018	December 2017
Off Balance Sheet <sup>1</sup>	Exposure Amount	Exposure Amount
• Derivatives	-	-
• Other	-	-
<b>Total Off Balance Sheet</b>	-	-

<sup>1</sup> Credit equivalent value

