HSBC Bank Australia Ltd

Pillar 3 Disclosures

30 September 2017

Consolidated Basis

HSBC

Contents

1. Introduction

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 unforseen 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
- 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.

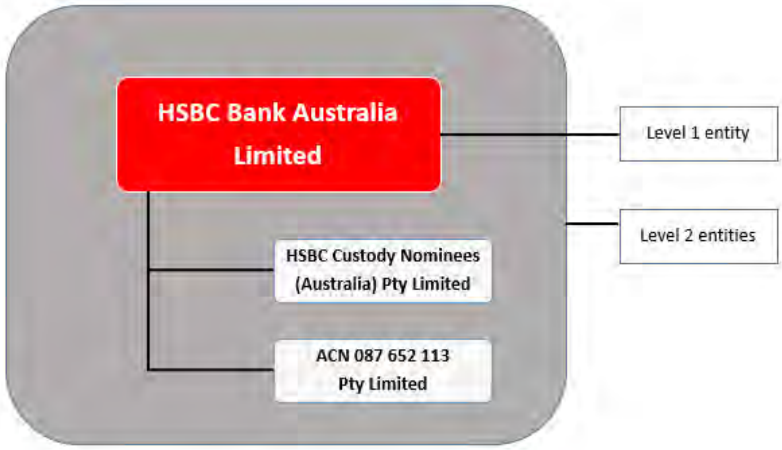
To view the main features of the current regulatory capital instruments please refer to the Regulatory Disclosures tab using the following link:

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

2. Scope of Application

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

The Pillar 3 disclosures have been appropriately verified internally but have not been audited by the external auditor.

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 31st 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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Risk Definitions

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.

Table 3 - Capital Adequacy (Consolidated)

All figures in AUDm

Capital requirements (in terms of risk weighted assets) for credit risk by portfolio	September 2017	June 2017
• Corporate	6,880	6,769
• Government	-	-
• Bank	630	681
• Residential Mortgage	6,049	5,901
• Other Retail	993	936
• All Other	85	162
Risk weighted assets – Credit risk excluding securitisation	14,637	14,449
• Securitisation	-	-
Total credit risk weighted assets	**14,637**	**14,449**
Capital requirements (in terms of risk weighted assets) for Market risk	53	40
Capital requirements (in terms of risk weighted assets) for Operational risk	1,830	1,830
Total risk weighted assets	**16,520**	**16,319**

Capital Ratios (for the consolidated banking group)	September 2017	June 2017
Common Equity Tier 1 capital ratio	10.29%	10.28%
Tier 1 capital ratio	11.80%	11.81%
Total capital ratio	13.98%	14.06%

Credit Risk Management

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. 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	September 2017 Total gross credit risk exposures	September 2017 Average gross exposure over the period	June 2017 Total gross credit risk exposures	June 2017 Average gross exposure over the period
• Cash and Liquid Assets	98	148	198	157
• Debt Securities	7,793	7,389	6,984	7,290
• Due from Other Financial Institutions	1,662	1,620	1,577	1,686
• Loans and Advances	21,694	21,588	21,482	21,181
• Derivatives	180	178	176	190
• Contingent Liabilities, Commitments and other Off-Balance Sheet Exposures	7,341	6,968	6,595	7,374
• Other Assets	196	199	200	184
Total Exposures	**38,964**	**38,090**	**37,212**	**38,062**

Portfolio Type	September 2017 Total gross credit risk exposures	September 2017 Average gross exposure over the period	June 2017 Total gross credit risk exposures	June 2017 Average gross exposure over the period
• Corporate	8,856	8,813	8,769	8,708
• Government	5,684	5,361	5,037	5,213
• Bank	6,447	6,125	5,802	6,627
• Residential Mortgage	16,904	16,709	16,514	16,448
• Other Retail	1018	993	968	968
• All Other	55	89	122	98
Total Exposures	**38,964**	**38,090**	**37,212**	**38,062**

Note: Total exposures are based on local APRA definitions.

Exposures

Impairment of loans and advances

It is the consolidated entity's policy that each operating company will recognise losses for impaired loans promptly where there is objective evidence that impairment of a loan or portfolio of loans has occurred. This is done on a consistent basis in accordance with the established Group guidelines. There are two basic methods of calculating impairment losses: those calculated on individual loans and those losses assessed on a collective basis.

- Individually assessed loans
  - impairment losses on individually assessed accounts are determined by an evaluation of the exposures on a case-by-case basis. The consolidated entity assesses at each balance sheet date whether there is any objective evidence that a loan is impaired. This procedure is applied to all accounts that are considered individually significant.

- Collectively assessed loans
  - in respect of losses which have been incurred but have not yet been identified on loans subject to individual assessment for impairment; and
  - for homogeneous groups of loans that are not considered individually significant.

Loan write-offs

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from the realisation of security have been received.

Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed to the extent it is now excessive by reducing the loan impairment allowance account. The amount of any reversal is recognised in the income statement.

Provisions for liabilities and charges

A provision is recognised in the balance sheet when the consolidated entity has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision for restructuring is recognised when the consolidated entity has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Future operating costs are not provided for.

Table 4(B) – Credit risk (Consolidated)

All figures in AUDm

Financial Position

Portfolios subject to Standardised approach	September 2017 Impaired Loans	Restructured Loans	Past due loans >90 days[1]	Provisions[1]
• Corporate	45.7	32.9	-	49.1
• Government	-	-	-	-
• Bank	18.1	-	-	16.1
• Residential Mortgage	12.8	14.6	67.5	1.0
• Other Retail	0.1	9.3	32.8	27.2
• All Other	-	-	-	-
Sub Total	**76.7**	**56.8**	**100.3**	**93.4**
Collective provision				14.3
Total Provisions				**107.7**

Portfolios subject to Standardised approach	June 2017 Impaired Loans	Restructured Loans	Past due loans >90 days[1]	Provisions[1]
• Corporate	69.8	38.9	-	52.9
• Government	-	-	-	-
• Bank	18.5	-	-	16.5
• Residential Mortgage	10.5	11.2	72.7	1.1
• Other Retail	0.1	12.0	33.4	29.8
• All Other	-	-	-	-
Sub Total	**98.9**	**62.1**	**106.1**	**100.3**
Collective provision				15.4
Total Provisions				**115.7**

[1] Includes individually and portfolio managed facilities.

All figures in AUDm

Financial Performance

Portfolios subject to Standardised approach [1]	September 2017 Charges for Provisions	Write offs	Recoveries	Total
• Corporate	8.2	-	(1.4)	6.8
• Government	-	-	-	-
• Bank	-	-	-	-
• Residential Mortgage	1.3	-	(2.1)	(0.8)
• Other Retail	7.0	32.9	(10.0)	29.9
• All Other	-	-	-	-
Sub Total	**16.5**	**32.9**	**(13.5)**	**35.9**
Movement in collective provision (not included above)	-	-	(5.1)	(5.1)
Total loan impairment charges and other movement in credit risk provisions	**16.5**	**32.9**	**(18.6)**	**30.8**

[1] Year-to-date figures.

Portfolios subject to Standardised approach [1]	June 2017 Charges for Provisions	Write offs	Recoveries	Total
• Corporate	0.1	-	(1.4)	(1.3)
• Government	-	-	-	-
• Bank	-	-	-	-
• Residential Mortgage	0.8	-	(1.6)	(0.8)
• Other Retail	6.6	21.7	(5.1)	23.2
• All Other	-	-	-	-
Sub Total	**7.5**	**21.7**	**(8.1)**	**21.1**
Movement in collective provision (not included above)	-	-	(4.0)	(4.0)
Total loan impairment charges and other movement in credit risk provisions	**7.5**	**21.7**	**(12.1)**	**17.1**

Table 4 (C) - General Reserve for Credit Losses

The Bank maintains a level of General Reserves, in addition to specific allowances, in order to absorb existing and potential future credit losses. A prudent level of General Reserves is dependent on the credit profile and business circumstances at the time and is compiled on the basis of expected losses on all exposures across the various risk portfolios.

The General Reserve consists of eligible Collective Impairment Provisions (CIP) raised under Australian International Financial Reporting Standards (AIFRS). Any shortfall in the level of the General Reserve, compared with regulatory expected losses, is fully deducted from retained earnings (Common Equity Tier 1 Capital).

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

All figures in AUDm

	September 2017	June 2017
General Reserve for Credit Losses	**109.8**	**117.6**

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.

- 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

a) No new securitisation or re-securitisation activity was undertaken during the June 2017 or September 2017 quarters relating to SPEs where the notes and receivables are owned by external parties.

b) There were no new on-balance sheet securitisation exposures retained or purchased during June 2017 or September 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

	September 2017	June 2017
Off Balance Sheet [1]	**Exposure Amount**	**Exposure Amount**
• Derivatives	-	-
• Other	-	-
Total Off Balance Sheet	-	-

[1] Credit equivalent value