­­HSBC Bank plc - Johannesburg Branch

Pillar 3 Half-year disclosure

June 2019

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| Contents  [Regulatory framework for disclosure 3](#_Toc22895955)  [Pillar 3 disclosures 3](#_Toc22895956)  [Report oversight 3](#_Toc22895957)  [Key Prudential matrics and overview of RWA 4](#_Toc22895958)  [Table 1: Key metrics (KM1) 4](#_Toc22895959)  [Risk management 5](#_Toc22895960)  [Table 2: Overview of risk management (OV1) 5](#_Toc22895961)  [Composition of capital 6](#_Toc22895962)  [Table 3: Composition of regulatory capital (CC1) 6](#_Toc22895963)  [Macroprudential supervisory measures 9](#_Toc22895964)  [Table 4 : Geographical distribution of credit exposures used in the countercyclical capital buffer (CCyB1) 9](#_Toc22895965)  [Leverage ratio 9](#_Toc22895966)  [Table 5: Summary comparison of accounting assets vs leverage ratio exposure (LR1) 9](#_Toc22895967)  [Table 6: Leverage ratio (LR2) 10](#_Toc22895968)  [Liquidity Risk 11](#_Toc22895969)  [Table 7: Liquidity coverage ratio (LIQ1) 12](#_Toc22895970)  [Table 8: Net stable ratio funding (NSFR) 13](#_Toc22895971)  [Credit risk 14](#_Toc22895972)  [Table 9: Credit quality of assets (CR1) 14](#_Toc22895973)  [Table 10: Changes in stock of defaulted loans and debt securities (CR2) 14](#_Toc22895974)  [Table 11: Credit risk mitigation techniques – overview (CR3) 14](#_Toc22895975)  [Table 12: Credit risk exposure and Credit Risk Mitigation (CRM) effects (CR4) 15](#_Toc22895976)  [Table 13: Standardised approach - exposures by asset classes and risk weights (CR5) 16](#_Toc22895977)  [Table 14: Analysis of counterparty credit risk (CCR) exposure by approach (CCR1) 17](#_Toc22895978)  [Table 15: Credit valuation adjustment (CVA) capital charge (CCR2) 17](#_Toc22895979)  [Table 16: Standardised approach - CCR exposures by regulatory portfolio and risk weights (CCR3) 18](#_Toc22895980)  [Market Risk 19](#_Toc22895981)  [Table 17: Market risk under the standardised approach (SA) (MR1) 19](#_Toc22895982)  [Table 18: Exposure to interest rate risk in the Banking Book 20](#_Toc22895983)  [Operational risk 21](#_Toc22895984)  [Table 19: Operational risk RWA’s 22](#_Toc22895985)  [Remuneration 23](#_Toc22895986)  [Abbreviations 24](#_Toc22895987) |

Regulatory framework for disclosure

HSBC Bank plc – Johannesburg Branch (‘HSBC JOH’) is supervised by the South African Reserve Bank Prudential Authority, which receives information on the capital adequacy of, and sets capital requirements for South African banks. The capital requirements is calculated based on the various regulations relating to financial services, including Basel Capital Accord (Basel) III. 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.

Pillar 3 disclosures

HSBC JOH’s Pillar 3 disclosures at 30 June 2019 comprise all information required under Pillar 3, both quantitative and qualitative. HSBC Group has implemented Basel Committee on Banking Supervision (‘BCBS’) final standards on revised Pillar 3 disclosures issued in January 2015. HSBC Holdings plc publishes comprehensive Pillar 3 disclosures annually and half yearly on the HSBC website www.hsbc.com, simultaneously with the release of the Annual Report and Accounts. 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 or other location.

Report oversight

HSBC JOH’s Executive committee (‘ExCo’) has the responsibility for the oversight of risk for the branch. At

30 June 2019, ExCo is satisfied that:

* HSBC’s risk, compliance, treasury and capital management generally operated effectively
* HSBC’s business activities have been managed within the ExCo-approved risk appetite
* HSBC is adequately funded and capitalised to support the execution its strategy.

During 2019, ExCo reviewed and approved the disclosure policy, which incorporates the revised pillar 3 disclosure requirements set out by the BCBS.

The ExCo is satisfied that this report has been prepared in accordance with the requirements of the disclosure policy and that an appropriate control framework has been applied in the preparation of this report.

All disclosures in this report are unaudited.

Key Prudential matrics and overview of RWA

Table 1: Key metrics (KM1)



Risk management

Table 2: Overview of risk management (OV1)



Composition of capital

Table 3: Composition of regulatory capital (CC1)







Macroprudential supervisory measures

Table 4 : Geographical distribution of credit exposures used in the countercyclical capital buffer (CCyB1)



Leverage ratio

Our leverage ratio calculated in accordance with South African Banks Act, 1990 was 9.21% at 30 June 2019, increased from 8.50% at 31 December 2018, mainly due to the decrease in balance sheet exposures.

Table 5: Summary comparison of accounting assets vs leverage ratio exposure (LR1)



Table 6: Leverage ratio (LR2)



Liquidity Risk

Liquidity risk is the risk that HSBC JOH does not have sufficient financial resources to meet its obligations as they fall due, or will have to access such resources at excessive cost. The risk arises from mismatches in the timing of cash flows. HSBC JOH follows the group liquidity framework.

The objective of the Group’s internal liquidity and funding risk management framework (‘LFRF’) is to allow it to withstand very severe liquidity stresses and be adaptable to changing business models, markets and regulations.

Liquidity is not managed through the explicit allocation of capital as, in common with standard industry practice, this is not considered to be an appropriate or adequate mechanism for managing these risks. However, the Bank recognises that a strong capital base can help to mitigate liquidity risk.

The primary sources of funding are customer current and savings accounts payable on demand or at short notice.

In HSBC JOH, Balance Sheet Management (‘BSM’) is responsible for managing liquidity and funding under the supervision of the local ALCO (which usually meets on a monthly basis) In executing the management of the liquidity risk on behalf of ALCO, and managing the interest rate risk in the banking book positions transferred to it, BSM invests in highly rated liquid assets in line with the Group’s liquid asset policy. The majority of the liquidity is invested in central bank deposits, South African Treasury bills and government securities with most of the remainder held in short-term interbank and central bank loans. Further details are provided on page 80 of the *HSBC Holdings plc Annual Report and Accounts 2018.*

Table 7: Liquidity coverage ratio (LIQ1)



Table 8: Net stable ratio funding (NSFR)



Credit risk

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. Credit risk represents our largest regulatory capital requirement.There have been no material changes to our policies and practices,which are described in the Pillar 3 Disclosures at 31 December 2018.

Table 9: Credit quality of assets (CR1)



Table 10: Changes in stock of defaulted loans and debt securities (CR2)



Table 11: Credit risk mitigation techniques – overview (CR3)



Table 12: Credit risk exposure and Credit Risk Mitigation (CRM) effects (CR4)



Table 13: Standardised approach - exposures by asset classes and risk weights (CR5)



Counterparty credit risk

Counterparty Credit Risk (‘CCR’) risk arises from derivatives and Security Financing Transactions (‘SFTs’). It is calculated in both the trading and non-trading books, and is the risk that a counterparty may default before settlement of the transaction.

Three approaches may be used to calculate exposure values for CCR: Current Exposure Methods (‘CEM’), standardised and IMM. Exposure values calculated under these approaches are used to determine RWAs. We use the CEM approach. Under the CEM, the EAD is calculated as current replacement cost plus regulatory add-ons.

Table 14: Analysis of counterparty credit risk (CCR) exposure by approach (CCR1)



Table 15: Credit valuation adjustment (CVA) capital charge (CCR2)



Table 16: Standardised approach - CCR exposures by regulatory portfolio and risk weights (CCR3)



Market Risk

HSBC JOH has adopted the Standardised Approach in respect of positions held in the trading book, and currently calculates capital on the current market value of interest rate and foreign exchange instruments held in the Branch’s trading books.

The objective of HSBC JOH’s market risk management is to manage and control market risk exposures in order to optimize return on risk while maintaining a market profile consistent with the Group’s status as a premier provider of financial products and services.

Main market risk exposures in South Africa are:

* Foreign exchange - arising from sales and trading of foreign exchange products such as spots, forwards, swaps and options; and
* Interest rate - arising from rates trading activity, sale of interest rate products to clients and balance sheet management activity.

There were no material changes to the policies and practices for the management of market risk.

Table 17: Market risk under the standardised approach (SA) (MR1)



Interest Rate Risk (Banking Book)

Interest rate risk in the banking book (‘IRRBB’) is defined as the exposure of non-trading products to interest rates. Interest rate risk in non-trading portfolios arises principally from repricing mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. The prospective change in future net interest income from non-trading portfolios will be reflected in the current realisable value of these positions, should they be sold or closed prior to maturity. In order to manage this risk optimally, market risk in non-trading portfolios is transferred to Markets under the supervision of ALCO. Interest rate risk is measured on a daily basis against regionally approved limits. The transfer of market risk to books managed by Global Markets is usually achieved by a series of internal deals between the business units and these books.

When the behavioural characteristics (repricing) of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the true underlying interest rate risk. ALCO is required to regularly monitor all such behavioural assumptions and interest rate risk positions, to ensure they comply with interest rate risk limits established by the Group.

Table 18: Exposure to interest rate risk in the Banking Book



Operational risk

Operational risk is the risk to achieving the 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 the business. It covers a wide spectrum of categories, in particular accounting tax, legal, regulatory compliance, financial crime, internal and external fraud, security of people, physical assets, information and cyber security, employment practices and relations, building unavailability and workplace safety, systems and data integrity, operations (transaction processing) and failure in other principal risk processes all fall within the definition of operational risk. HSBC JOH has historically experienced operational risk losses in the following major event types:

* internal fraud;
* business disruption and systems failure; and
* execution, delivery, and process management.

And under the following categories:

* trading and sales; and
* commercial banking.

The regulatory environment in which HSBC JOH operates is increasing the cost of doing business and could reduce our future profitability. HSBC continued the ongoing work to strengthen those controls that manage the most material risks. We further developed controls to help ensure that we know our customers, ask the right questions, monitor transactions and escalate concerns to detect, prevent and deter financial crime risk.

HSBC JOH has historically adopted, and currently uses, the standardised approach (TSA) in determining the operational risk capital requirement and has in place an operational risk model.

HSBC JOH recognises that operational risk losses can be incurred for a wide variety of reasons, including rare but extreme events. The objective of operational risk management is to manage and control operational risk in a cost-effective manner and within risk appetite, as defined by the Risk Management Meeting guided by the Group. Material losses and near-misses are recorded in an event and impact management module in the operational risk management system of record.

Responsibility for managing operational risk lies with all HSBC’s employees. During 2019 we continued to strengthen our approach to managing operational risk as set out in the operational risk management framework (‘ORMF’). The approach sets out governance, appetite and provides a single view of non-financial risks, and associated controls. It incorporates a risk management system to enable active risk management. The enhancement and embedding of the risk appetite framework for non-financial risk, and the improvement of the consistency of the adoption of the end-to-end risk and control assessment processes were a particular focus in 2019. While there remains more to do, we made progress in strengthening the control environment and the management of non-financial risk. Activities to strengthen the three lines of defence model, continued to be a key focus in 2019.

The first line of defence owns the risk and is responsible for identifying, recording, reporting, managing the risks and ensuring that the right controls and assessments are in place to mitigate these risks. The second line of defence sets the policy and guidelines for managing the risks and provides advice, guidance and challenge to the first line of defence on effective risk management. The third line of defence is Internal Audit which independently ensures we are managing risk effectively.

At HSBC JOH business managers are responsible for maintaining an appropriate level of internal control, commensurate with the scale and nature of operations. They are responsible for identifying and assessing material risks, designing key controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

Operational risk and control assessments are performed by HSBC JOH global business and product units:

* Global Banking and Commercial Banking;
* Global Markets;
* Global Trade and Receivable Finance; and
* Global Liquidity and Cash management.

Key controls are owned and operated by global businesses and/or by global functions including (HOST)

The risk and control assessment process is designed to provide business areas and functions with a forward-looking view of operational risks, an assessment of the effectiveness of controls, and a tracking mechanism for action plans so that they can proactively manage operational risks within acceptable levels.

HSBC JOH uses a group-wide operational risk management system to record the results of our operational risk management process.

Operational Risk RWA’s remained consistent with 2018.

Table 19: Operational risk RWA’s



Remuneration

HSBC JOH follows the approach adopted by the Group. The principle purpose of HBSC group’s remuneration strategy is to reward competitively the achievement of long-term sustainable performance and attract and motivate the very best people who are committed to maintaining a long-term career with the group and performing their role in the long-term interests of the shareholders. A global reward strategy for the HSBC group was approved by the Group Remuneration Committee. This strategy provided a reward framework for the group which HSBC JOH follows. Key principles of the remuneration strategy are:

* Assess performance and values-aligned behavior with reference to clear and relevant objectives set within a balanced scorecard framework;
* Under this framework, objectives are set under four categories – financial, process (including risk mitigation), customer and people. Significant importance is given to the achievement of efficiency and risk objectives as well as financial objectives; and
* Objectives relating to customer development and the productivity of human capital are key to sustained financial performance and the development of HSBC JOH and group over the short and medium term.

As a wholly owned subsidiary, HSBC Bank plc and its branches are subject to the remuneration policy established by the Group. Details of the Group’s remuneration policy, including details on the remuneration committee membership and its activities, the remuneration strategy and tables showing the remuneration details of HSBC’s identified staff and material risk takers may be found in the remuneration policy on the website (http://www.hsbc.com/investor-relations/governance) and in the directors’ remuneration report on page 172 of the *HSBC Holdings plc Annual Report and Accounts 2018*.

HSBC JOH does not have its own remuneration committee. The group considers South Africa in its deliberation via the functions and lines of business. As a result, JOH does not have its own remuneration pool on an entity approved basis but rather at a function and lines of business. Each function and line of business is separately assessed at the group level, this includes the risk function.

Abbreviations

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| **AFS** | Annual Financial Statements |
| **ALCO** | Asset and Liability Committee |
| **BCBS** | Basel Committee and Banking Supervision |
| **BSM** | Balance Sheet Management |
| **CEM** | Current Exposure Method |
| **CRA** | Credit Risk Adjustments |
| **CRM** | Credit Risk Mitigation |
| **CCR** | Counterparty Credit Risk |
| **CCF** | Credit Conversion Factor |
| **CRO** | Chief Risk Officer |
| **CVA** | Credit Valuation Adjustment |
| **EAD** | Exposure at Default |
| **ECAs** | Export Credit Agency |
| **ExCo** | Executive Committee |
| **FI** | Financial Institutions |
| **HBEU** | HSBC Bank plc |
| **HSBC JOH** | HSBC Bank plc Johannesburg Branch |
| **HQLA** | Highly Qualifying Liquid Assets |
| **IRB** | Internal Rating Based |
| **IMM** | Internal Model Method |
| **LCR** | Liquidity Coverage Ratio |
| **NSFR** | Net Stable Ratio Funding |
| **ORMF** | Operational Risk Management Framework |
| **RAS** | Risk Appetite Statement |
| **RMM** | Risk Management Meeting |
| **RWA** | Risk Weighted Assets |
| **SFT** | Securities Funding Transactions |
| **WMR** | Wholesale Market Risk |