The Hongkong and Shanghai Banking Corporation Limited
Bangladesh Branches

Disclosures on risk based capital under Pillar - III of Basel II
for the year ended 31 December 2014

1 Scope of application

The Bank has no subsidiaries or significant investments and Basel II is applied at Bank level only.

2 Capital structure

Qualitative disclosures:

HSBC Bangladesh's capital structure consists of Tier I capital and Tier II capital. Regulatory capital is broadly classified into three categories – Tier I, Tier II and Tier III. The computation of the amount of core (Tier I) and supplementary (Tier II and Tier III) capitals shall be subject to the following conditions:

- The Bank has to maintain at least 50% required capital as Tier I capital.
- The amount of Tier II capital will be limited to 100% of the amount of Tier I capital.
- Fifty percent (50%) of asset revaluation reserves shall be eligible for Tier II i.e supplementary capital.
- A minimum of about 28.5% of market risk needs to be supported by Tier I capital. Supporting of market risk from Tier III capital shall be limited up to a maximum of 250% of a Bank's Tier I capital that is available after meeting credit risk capital requirement.
- Up to 50% of Revaluation Reserves for Securities shall be eligible for Tier II i.e supplementary capital.
- Subordinated debt shall be limited to a maximum of 30% of the amount of Tier I capital.

Tier I capital of the Bank includes funds deposited with Bangladesh Bank, actuarial gain/(loss) and retained earnings. Tier 1 capital is also called 'Core Capital' of the Bank. According to BRPD Circular No. 11 (12 December 2011) deferred tax recognition on specific provision shall be deducted from the retained earnings when calculating the capital adequacy ratio.

Tier II (supplementary capital) consists of general provision and 50% of revaluation reserve for Held to Maturity (HTM) and Held for Trading (HFT) securities.

The use of Tier III (short term subordinated debt) is limited only for part of the requirements of the explicit capital charge for market risks. The Bank does not have any Tier III capital.

Quantitative disclosures:

The details of capital structure are provided as under:

	2014 BDT	2013 BDT
Tier I		
Fund deposited with Bangladesh Bank	2,912,626,135	2,890,631,697
Retained earnings	19,346,766,170	17,332,991,982
Actuarial loss	(106,859,103)	(34,207,625)
Deferred Tax Asset on Specific Provision	(157,669,561)	(37,110,611)
	21,994,863,641	**20,152,305,443**
Tier II		
General provision	2,573,452,522	2,348,132,019
Unrealized surplus on amortization of HTM securities	84,949,115	63,218,730
Unrealized surplus on revaluation of HFT securities	-	27,026,299
	2,658,401,637	**2,438,377,048**
	24,653,265,278	**22,590,682,491**

3 Capital adequacy

Qualitative disclosures:

The Bank has adopted the Standardised Approach for computation of the capital charge for credit risk and market risk, and the Basic Indicator Approach for operational risk. Assessment of capital adequacy is carried out in conjunction with the capital adequacy reporting to the Bangladesh Bank.

The Bank has a capital adequacy ratio of 24.29% as against the minimum regulatory requirement of 10%. Tier I capital adequacy ratio is 21.67% against the minimum regulatory requirement of 5%. The Bank's policy is to manage and maintain its capital with the objective of maintaining a strong capital ratio and high rating. The Bank maintains capital levels that are sufficient to absorb all material risks. The Bank also ensures that the capital levels comply with regulatory requirements and satisfy external rating agencies and other stakeholders including depositors. The whole objective of the capital management process in the Bank is to ensure that the Bank remains adequately capitalized at all times.

The Bank has in place a capital adequacy framework by which the Bank's annual budget projections and the capital required to achieve the business objectives are linked in a cohesive way. Capital requirements are assessed for credit, market and operational risks. The Bank's capital adequacy ratio is periodically assessed and reviewed by the ALCO and reported to head office. The composition of capital in terms of Tier I, II and III are also analysed to ensure capital stability and to reduce volatility in the capital structure. The Bank has a profit remittance policy to ensure that the Bank has enough capital to comply with the regulatory requirement. The Bank's capital plan also ensures that adequate levels of capital are held considering the planned organic growth of the business.

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Quantitative disclosures:

Position of various risk weighted assets are presented below:	**2014**	**2013**
	BDT	**BDT**
	Risk Weighted Assets	Risk Weighted Assets
On balance sheet items	49,743,708,217	65,104,627,227
Off balance sheet items	28,385,480,903	19,112,490,415
Total credit risk	78,129,189,120	84,217,117,642
Market risk	5,351,178,658	3,123,859,089
Operational risk	18,010,378,799	14,967,172,318
Total risk weighted assets	**101,490,746,577**	**102,308,149,049**

Detail of capital adequacy	**2014**	**2013**
	BDT	**BDT**
Capital requirement for credit risk	7,812,918,912	8,421,711,764
Capital requirement for market risk	535,117,866	312,385,909
Capital requirement for operational risk	1,801,037,880	1,496,717,232
Total required capital	**10,149,074,658**	**10,230,814,905**
Total Tier I capital	21,994,863,641	20,152,305,443
Total Tier II capital	2,658,401,637	2,438,377,048
Total Tier III capital	-	-
Total regulatory capital	**24,653,265,278**	**22,590,682,491**
Surplus	**14,504,190,620**	**12,359,867,586**
% of Capital adequacy required		
Tier I	5%	5%
Total	10%	10%
% of Capital adequacy maintained		
Tier I	21.67%	19.70%
Total	24.29%	22.08%

4 Credit Risk

Qualitative disclosures:

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, trade finance and leasing business, but also from off balance sheet products such as guarantees and credit derivatives, and from the holdings of debt securities. HSBC Bangladesh has standards, policies and procedures dedicated to controlling and monitoring risk from all such activities. Among the risks the HSBC Bangladesh engages in, credit risk generates the largest regulatory capital requirement.

The aims of credit risk management, underpinning sustainably profitable business, are principally

- to maintain a strong culture of responsible lending, supported by a robust risk policy and control framework;
- to both partner and challenge business originators effectively in defining and implementing risk appetite, and its re-evaluation under actual and scenario conditions; and
- to ensure independent, expert scrutiny and approval of credit risks, their costs and their mitigation.

The standardised approach is applied for risk weighting of exposure as per directive of Bangladesh Bank. It requires banks to use risk assessments prepared by External Credit Assessment Institutions (ECAIs) to determine the risk weightings applied to rated counterparties. The Bank has applied some customer ratings based on their entity rating as assigned by the approved ECAIs of Bangladesh Bank.

It is HSBC's policy to establish that loans are within the customer's capacity to repay, rather than to rely excessively on security. Depending on the customer's standing and the type of product, facilities may be unsecured. Nevertheless, collateral can be an important mitigant of credit risk.

The Bank has guidelines on the acceptability of specific classes of collateral or credit risk mitigation, and determines suitable valuation parameters. Such parameters are expected to be conservative, reviewed regularly and supported by empirical evidence. Security structures and legal covenants are required to be subject to regular review to ensure that they continue to fulfill their intended purpose and remain in line with local market practice. The principal collateral types are as follows:

- Cash collateral
- In the personal sector, mortgages over residential properties
- In the commercial and industrial sector, charges over business assets such as premises, stock and debtors

Special attention is paid to problem loans and appropriate action is initiated to protect the Bank's position on a timely basis and to ensure that loan impairment methodologies result in losses being recognised when they are incurred. The objective of credit risk management is to minimize the probable losses and maintaining credit risk exposure within acceptable parameters.

HSBC has historically sought to maintain a conservative, yet constructive and competitive credit risk culture. This has served the Group well, through successive economic cycles and remains valid today. This culture is determined and underpinned by the disciplined credit risk control environment which the Group has put in place to govern and manage credit risk, and which is embodied in the formal policies and procedures adopted by HSBC Bangladesh. These are articulated through Group credit policies supplemented by regional and local area lending guidelines, backed up by the Bangladesh Bank's "Managing Core Risks in Banking - Credit Risk Management - Industry Best Practices". Formal policies and procedures cover all areas of credit lending and monitoring processes including:

- The Group Credit Risk Policy Framework
- Risk appetite and evaluation of facilities
- Key lending constraints and higher-risk sectors
- Risk rating systems
- Facility structures
- Lending to banks, non-banks and sovereigns
- Personal lending
- Corporate and commercial lending
- Portfolio management and stress testing
- Monitoring, control and the management of problem exposures
- Impairments and allowances

At the heart of these processes is a robust framework of accountability. HSBC operates a system of personal credit authorities, not credit committee structures. Relationship Managers are held accountable for both the profitability and growth of their loan portfolios as well as the losses that may arise within them.

The Bank also has established a separate Risk and Credit Control Department which looks after the loan review mechanism and also helps in ensuring credit compliance with the post-sanction processes/ procedures laid down by the Bank from time to time. This involves taking up independent account-specific reviews of individual credit exposures as per the approved lending guideline. The Risk department also monitors various credit concentration limits. The Bank has in place a risk grading system for analysing the risk associated with credit. The parameters for risk grading customers include financial condition and performance, quality of disclosures and management, facility structure, collateral and country risk assessment where necessary. Maximum funded counterparty/group exposures are limited to 15% of the Bank's capital base as stipulated by Bangladesh Bank. Where a higher limit is required for projects of national importance prior approval of Bangladesh Bank is obtained.

Past dues and impaired exposures are defined in accordance with the relevant Bangladesh Bank regulations. Specific and general provisions are computed periodically in accordance with Bangladesh Bank regulations.

Credit risk mitigation

The Bank has adopted the simple approach for credit risk mitigation under the standardised approach where only cash collaterals are considered against the exposures to calculate the net exposure with applicable hair cut.

Specific provision

The Bank follows Bangladesh Bank guidelines regarding loan classifications, provisioning and any other issues related to Non Performing Loan (NPL). The Bank's internal credit guidelines also give direction on the management of non performing loans, the procedure for reviewing loan provisioning, debt write off, facility grading, reporting requirements and interest recognition. However, the Bank's guidelines will not supersede local regulations. Thus, while dealing with non performing loans, the Bank's decision is always compliant with local rules and regulations as well as Group guidelines which are more conservative than local regulations.

Throughout the year the Bank reviews loans and advances to assess whether objective evidence has arisen of impairment of a loan or portfolio that warrants a change in the classification of loans and advances which may result in a change in the provision required in accordance with BRPD circular no.14 (23 September 2012) as amended by BRPD circular no. 19 (27 December 2012). The guidance in the circulars follows a formulaic approach whereby specified rates are applied to the various categories of loans as defined in the circulars. The provisioning rates are as follows:

Specific provision on loans and advances

Specific provision on substandard loans and advances/investments other than agricultural loans	20%
Specific provision on doubtful loans and advances/investment other than agricultural loans	50%
Specific provision on substandard and doubtful agricultural loans	5%
Specific provision on bad / loss and advances/investments	100%

BRPD circular no.14 (23 September 2012) as amended by BRPD circular no. 19 (27 December 2012) also provides scope for further provisioning based on qualitative judgments. In these circumstances, impairment losses are calculated on individual loans considered individually significant based on which specific provisions are raised. If the specific provisions assessed under the qualitative methodology are higher than the specific provisions assessed under the formulaic approach above, the higher of the two is recognised in liabilities under "Provisions for loans and advances" with any movement in the provision charged/released in the profit and loss account.

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Quantitative disclosures:

Gross Credit Risk Exposure	**2014 BDT**	**2013 BDT**
Claims on sovereigns and central banks	16,474,275,386	16,308,889,475
Claims on banks	3,516,476,901	3,028,251,454
Investments	11,573,535,289	7,610,346,830
Claims on corporate	56,376,265,738	49,861,815,594
Claims on consumer	10,361,597,969	13,204,516,929
Fixed assets	455,956,480	428,180,239
All other assets	2,781,977,847	12,792,110,578
Total on-balance sheet items	101,540,085,610	103,234,111,099
Off-balance sheet items (after considering the credit conversion factor)	35,929,265,244	31,766,991,721
Total	**137,469,350,854**	**135,001,102,820**

Geographical distribution of credit exposures

2014	**Dhaka**	**Chittagong**	**Sylhet**	**Total BDT**
Claims on sovereigns and central banks	14,523,678,940	1,401,616,976	548,979,470	16,474,275,386
Claims on banks	3,516,476,901	-	-	3,516,476,901
Investments	11,571,553,789	1,861,000	120,500	11,573,535,289
Claims on corporate	49,864,820,413	6,511,445,325	-	56,376,265,738
Claims on consumer	8,311,986,121	1,634,861,904	414,749,944	10,361,597,969
Fixed assets	446,308,842	7,849,228	1,798,410	455,956,480
All other assets	2,779,771,542	2,068,993	137,311	2,781,977,847
Total on-balance sheet items	91,014,596,548	9,559,703,426	965,785,635	101,540,085,610
Off-balance sheet items	20,560,307,453	15,368,957,791	-	35,929,265,244
Total	**111,574,904,001**	**24,928,661,217**	**965,785,635**	**137,469,350,854**

2013	**Dhaka**	**Chittagong**	**Sylhet**	**Total BDT**
Claims on sovereigns and central banks	15,391,370,120	575,078,714	342,440,641	16,308,889,475
Claims on banks	3,028,251,454	-	-	3,028,251,454
Investments	7,608,786,430	1,560,000	400	7,610,346,830
Claims on corporate	44,025,002,411	5,836,813,183	-	49,861,815,594
Claims on consumer	10,569,507,110	2,089,918,498	545,091,321	13,204,516,929
Fixed assets	415,127,555	11,039,696	2,012,988	428,180,239
All other assets	12,791,025,349	941,027	144,202	12,792,110,578
Total on-balance sheet items	93,829,070,429	8,515,351,118	889,689,552	103,234,111,099
Off-balance sheet items	16,325,263,817	15,441,727,904	-	31,766,991,721
Total	**110,154,334,246**	**23,957,079,022**	**889,689,552**	**135,001,102,820**

Industry distribution of exposures

2014	**Banks and FIs**	**Manufacturing**	**Industry**	**Retail**	**Others**	**Total BDT**
Claims on sovereigns and central banks	16,474,275,386	-	-	-	-	16,474,275,386
Claims on banks	3,516,476,901	-	-	-	-	3,516,476,901
Investments	-	-	-	-	11,573,535,289	11,573,535,289
Claims on corporate	-	25,946,675,845	22,003,026,679		8,426,563,214	56,376,265,738
Claims on consumer	-	-	-	10,361,597,969	-	10,361,597,969
Fixed assets	-	-	-	-	455,956,480	455,956,480
All other assets	-	-	-	-	2,781,977,847	2,781,977,847
Total on-balance sheet items	19,990,752,287	25,946,675,845	22,003,026,679	10,361,597,969	23,238,032,830	101,540,085,610
Off-balance sheet items	10,080,991,991	-	-	-	25,848,273,253	35,929,265,244
Total	**30,071,744,278**	**25,946,675,845**	**22,003,026,679**	**10,361,597,969**	**49,086,306,083**	**137,469,350,854**

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2013	Banks and FIs	Manufacturing	Industry	Retail	Others	Total BDT
Claims on sovereigns and central banks	16,308,889,475	-	-	-	-	16,308,889,475
Claims on banks	3,036,360,146	-	-	-	-	3,036,360,146
Investments	-	-	-	-	7,610,346,830	7,610,346,830
Claims on corporate	-	24,625,909,234	18,388,493,668	-	6,839,304,000	49,853,706,902
Claims on consumer	-			13,204,516,929	-	13,204,516,929
Fixed assets	-	-	-	-	428,180,239	428,180,239
All other assets	10,942,193,854	-	-	-	1,849,916,724	12,792,110,578
Total on-balance sheet items	30,287,443,475	24,625,909,234	18,388,493,668	13,204,516,929	16,727,747,793	103,234,111,099
Off-balance sheet items	18,705,759,083	-	-	-	13,061,232,638	31,766,991,721
Total	**48,993,202,558**	**24,625,909,234**	**18,388,493,668**	**13,204,516,929**	**29,788,980,431**	**135,001,102,820**

Maturity breakdown of credit exposures

2014	Within 1 month	Within 1 to 3 months	Within 3 to 12 months	Within 1 to 5 years	Over 5 years	Total BDT
Claims on sovereigns and central banks	13,662,361,895	-	-	-	2,811,913,491	16,474,275,386
Claims on banks	3,516,476,901	-	-	-		3,516,476,901
Investments	820,236,422	1,876,266,535	3,675,903,661	3,954,249,584	1,246,879,087	11,573,535,289
Claims on corporate	16,960,734,824	17,452,781,235	15,448,023,476	6,514,726,203	-	56,376,265,738
Claims on consumer	726,489,829	215,334,384	240,256,941	5,134,449,674	4,045,067,141	10,361,597,969
Fixed assets	150,758	357,645	18,703,675	346,427,322	90,317,080	455,956,480
All other assets	211,750,020	558,735,984	754,102,700	503,968,815	753,420,328	2,781,977,847
Total on-balance sheet items	35,898,200,649	20,103,475,783	20,136,990,453	16,453,821,598	8,947,597,127	101,540,085,610
Off-balance sheet items	3,704,636,229	9,756,092,510	11,803,683,459	10,664,853,046	-	35,929,265,244
Total	**39,602,836,878**	**29,859,568,293**	**31,940,673,912**	**27,118,674,644**	**8,947,597,127**	**137,469,350,854**

2013	Within 1 month	Within 1 to 3 months	Within 3 to 12 months	Within 1 to 5 years	Over 5 years	Total BDT
Claims on sovereigns and central banks	13,518,970,422	-	-	-	2,789,919,053	16,308,889,475
Claims on banks	3,028,251,454	-	-	-	-	3,028,251,454
Investments	883,243,698	2,025,066,853	1,139,351,828	2,358,850,810	1,203,833,641	7,610,346,830
Claims on corporate	18,287,632,143	14,106,975,444	12,049,667,844	5,417,540,163	-	49,861,815,594
Claims on consumer	871,533,406	224,178,579	397,106,986	6,708,972,275	5,002,725,682	13,204,516,928
Fixed assets	5,942,664	9,488,442	24,522,164	302,131,256	86,095,713	428,180,239
All other assets	11,134,806,291	361,560,055	399,341,602	266,834,980	629,567,651	12,792,110,579
Total on-balance sheet items	47,730,380,078	16,727,269,373	14,009,990,424	15,054,329,484	9,712,141,740	103,234,111,099
Off-balance sheet items	5,280,131,915	8,212,784,801	8,476,443,365	9,797,631,640	-	31,766,991,721
Total	**53,010,511,993**	**24,940,054,174**	**22,486,433,789**	**24,851,961,124**	**9,712,141,740**	**135,001,102,820**

Gross Non Performing Assets (NPAs)	**2014 BDT**	**2013 BDT**
Non Performing Assets (NPAs) to outstanding loans and advances	1,404,462,607	1,345,055,443
Movement of NPAs		
Opening Balance	1,345,055,443	684,756,154
Written off during the period	(125,698,027)	(189,923,497)
Recoveries during the period	(374,117,460)	(273,952,540)
Addition during the period	559,222,651	1,124,175,326
Closing Balance	**1,404,462,607**	**1,345,055,443**
Movement of specific provision for NPAs		
Opening Balance	457,926,415	213,649,951
Written off (net off recovery) during the period	(41,049,798)	(94,645,558)
Recoveries during the period	(143,478,007)	(168,866,946)
Provision made during the period	145,554,600	507,788,968
Closing Balance	**418,953,210**	**457,926,415**

5 Equities: Disclosures for banking book positions

The bank does not hold trading position in equities.

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6 Interest rate risk in the banking book

Discussed in the next section under Market risk.

7 Market risk

Qualitative disclosures:

Market risk is the risk to the Bank's earnings and capital due to changes in the market level of interest rates or prices of securities, foreign exchange and equities, as well as the volatilities of those changes.

The Bank uses the standardised (market risk) approach to calculate market risk for trading book exposures. The trading book consists of positions in financial instruments held with trading intent or in order to hedge other elements of the trading book. A capital charge will be applicable for financial instruments which are free from any restrictive covenants on tradability, or able to be hedged completely. Generally, investments in 'Held for Trading' portfolios are focal parts of the trading book.

Capital charge means an amount of regulatory capital which the Bank is required to hold for an exposure to a relevant risk which, if multiplied by 10, becomes the risk-weighted amount of that exposure for that risk.

The Bank has a comprehensive treasury risk policy which inter alia covers assessment, monitoring and management of all the above market risks. The Bank has defined various internal limits to monitor market risk and is computing the capital requirement as per the standardised approach of Basel II.

Details of various market risks faced by the Bank are set out below:

Interest rate exposures

The Bank adopts the maturity method in measuring interest rate risk in respect of securities in the trading book. The capital charge for the entire market risk exposure is computed under the standardised approach using the maturity method and in accordance with guidelines issued by Bangladesh Bank.

Interest rate exposures in the banking book

Interest rate risk is the risk where changes in market interest rates might adversely affect a bank's financial condition. The immediate impact of changes in interest rates is on the Net Interest Income (NII). A long term impact of changing interest rates is on the Bank's net worth since the economic value of a Bank's assets, liabilities and off-balance sheet positions are affected by a variation in market interest rates. The responsibility of interest rate risk management rests with the Bank's Asset and Liability Management Committee (ALCO) and Global Markets (GM) department. The Bank periodically computes the interest rate risk on the banking book that arises due to re-pricing mismatches in interest rate sensitive assets and liabilities. For the purpose of monitoring such interest rate risk, the Bank has in place a system that tracks the re-pricing mismatches in interest bearing assets and liabilities. For computation of the interest rate mismatches the guidelines of Bangladesh Bank are followed.

Details relating to re-pricing mismatches and the interest rate risk thereon are reported to ALCO regularly. In addition, scenario analysis assuming a 100 basis point parallel shift in interest rates and the impact on the interest income and net profit of the Bank are assessed on a quarterly basis and reported to ALCO with proposals for corrective action if necessary.

Foreign exchange risk

Foreign exchange risk is defined as the risk that a bank may suffer losses as a result of adverse exchange rate movements during a period in which it has an open position, either spot or forward, or a combination of the two, in an individual foreign currency. The responsibility of management of foreign exchange risk rests with the Global Markets department of the Bank. The Bank has set up internal limits to monitor foreign exchange open positions. Foreign exchange risk is computed on the sum of net short positions or net long positions, whichever is higher of the foreign currency positions held by the Bank.

Equity position risk

The Bank does not hold a trading position in equities.

Quantitative disclosures:

The capital charge for various components of market risk is presented below:

The capital requirement for:	**2014**	**2013**
	BDT	**BDT**
Interest rate risk	294,372,839	154,426,540
Equity position risk	-	-
Foreign exchange risk	240,745,027	157,959,369
Commodity risk	-	-
	535,117,866	**312,385,909**

8 Operational risk

Qualitative disclosures:

Operational risk is the risk of loss arising from fraud, unauthorised activities, error, omission, inefficiency, systems failure or external events. It is inherent in every business organisation and covers a wide spectrum of issues. The Group manages this risk through a control based environment in which processes are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by an independent programme of periodic reviews undertaken by internal audit, and by monitoring external operational risk events, which ensure that the Group stays in line with industry best practice and takes account of lessons learned from publicised operational failures within the financial services industry.

The Group has codified its operational risk management process by issuing a high level standard, supplemented by more detailed formal guidance. This explains how the Group manages operational risk by identifying, assessing, monitoring, controlling and mitigating the risk, rectifying operational risk events, and implementing any additional procedures required for compliance with local regulatory requirements. The standard covers the following:

- Operational risk management responsibility is assigned to senior management within the business operation;
- Information systems are used to record the identification and assessment of operational risks and to generate appropriate, regular management reporting;
- Assessments are undertaken of the operational risks facing each business and the risks inherent in its processes, activities and products. Risk assessment incorporates a regular review of identified risks to monitor significant changes;
- Operational risk loss data is collected and reported to senior management. Aggregate operational risk losses are recorded and details of incidents above a materiality threshold are reported to the Group's Audit Committee; and
- Risk mitigation, including insurance, is considered where this is cost-effective.

The Group maintains and tests contingency facilities to support operations in the event of disasters. Additional reviews and tests are conducted in the event that any HSBC office is affected by a business disruption event, to incorporate lessons learned in the operational recovery from those circumstances. Plans have been prepared for the continued operation of the Group's business, with reduced staffing levels.

In line with the instructions from the Bangladesh Bank, the Bank uses the basic indicator approach to calculate its operational risk.

Quantitative disclosures:

	2014 **BDT**	**2013** **BDT**
Capital charge for operational risk	1,801,037,880	1,496,717,232