# HSBC, Bangladesh

Disclosures on risk based capital
under Pillar - III of Base III
for the year ended 31 December 2015

# The Hongkong and Shanghai Banking Corporation Limited
# Bangladesh Branch

## Disclosures on risk based capital under Pillar - III of Basel III
## for the year ended 31 December 2015

### 1 Disclosure policy

The following detailed qualitative and quantitative disclosures are provided in accordance with Bangladesh Bank rules and regulations on capital adequacy under Basel III issued through BRPD Circular no. 18 (21 December 2014). The purpose of these requirements is to complement the capital adequacy requirements and the Pillar III – supervisory review process. These disclosures are intended for market participants to assess key information about the Bank's exposure to various risks and to provide a consistent and understandable disclosure framework as per regulatory requirement. The Bank has an approved disclosure policy to observe the disclosure requirements set out by the Bangladesh Bank and International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) as adopted by the Institute of Chartered Accountants of Bangladesh (ICAB) into Bangladesh Accounting Standards (BAS) and Bangladesh Financial Reporting Standards (BFRS) where relevant to the Bank.

The major highlights of the Bangladesh Bank regulations are:

- ▶ To maintain Capital Adequacy Ratio (CAR) at a minimum of 10% of Risk Weighted Assets (RWA);
- ▶ To adopt the standardised approach for credit risk for implementing Basel III, using national discretion for:
  - adopting the credit rating agencies as External Credit Assessment Institutions (ECAI) for claims on sovereigns and banks;
  - adopting simple/comprehensive approach for Credit Risk Mitigation (CRM);
  - all unrated corporate exposures are risk weighted by assigning a risk weighting of 125%.
- ▶ To adopt the standardized approach for market risk and basic indicator approach for operational risk.
- ▶ Capital adequacy returns must be submitted to Bangladesh Bank on a quarterly basis.

### 2 Scope of application

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

### 3 Capital structure

***Qualitative disclosures:***

HSBC Bangladesh's capital structure consists of Tier I and Tier II capital which is aligned with regulatory capital structure. Tier I capital is further categorised as Common Equity Tier 1 (CET1) and Additional Tier 1 capital. The computation of the amount of Common Equity Tier I, Additional Tier I and Tier II capital shall be subject to the following conditions:

- The Bank has to maintain at least 4.50% of total Risk Weighted Assets (RWA) as Common Equity Tier I capital.
- Tier I capital will be at least 5.50% of the total RWA.
- Minimum Capital to Risk-weighted Asset Ratio (CRAR) will be 10% of the total RWA.
- Additional Tier I capital can be maximum up to 1.5% of the total RWA or 33.33% of CET 1, whichever is higher.
- Tier II capital can be maximum up to 4% of the total RWA or 88.89% of CET1, whichever is higher.
- In addition to minimum CRAR, Capital Conservation Buffer (CCB) @ 0.625% of the total RWA will be maintained in the form of CET1 in a phased manner from 2016 to 2019.

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 letter ref no.BRPD (BFIS)661/14B(P)/2015-18014 dated 24 December 2015, 5% of deferred tax recognised on specific provision shall be allowable as CET 1 capital whilst all other deferred tax assets created on other items shall be deducted from the retained earnings when calculating the capital adequacy ratio.

Tier II capital consists of general provision and revaluation reserve for Held to Maturity (HTM) and Held for Trad-

ing (HFT) securities. General provision for inclusion in Tier II capital is limited to a maximum 1.25% of Credit RWA calculated under the standardised approach. Revaluation reserve for securities shown as Tier II capital as on 31 December 2014 will be nullified in a phased manner at the rate of 20% starting from 2015 and will be fully adjusted by 2020.

***Quantitative disclosures:***

The details of capital structure are provided as under:

| | 2015<br>BDT | 2014<br>BDT |
|---|---:|---:|
| **Common Equity Tier I** | | |
| Fund deposited with Bangladesh Bank | 2,922,383,472 | 2,912,626,135 |
| Retained earnings | 24,521,203,746 | 19,346,766,170 |
| Actuarial gain / (loss) | (175,800,201) | (106,859,103) |
| Less: Regulatory adjustment for deferred tax assets as per the Bangladesh Bank guideline | (304,333,865) | (157,669,561) |
| | 26,963,453,152 | 21,994,863,641 |
| **Additional Tier I** | - | - |
| | - | - |
| **Total Tier I** | 26,963,453,152 | 21,994,863,641 |
| **Tier II** | | |
| General provision | 1,041,738,451 | 2,573,452,522 |
| Revaluation reserve for securities | 67,959,292 | 84,949,115 |
| | 1,109,697,743 | 2,658,401,637 |
| **Total capital** | 28,073,150,895 | 24,653,265,278 |

**4 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 26.73% as against the minimum regulatory requirement of 10%. Tier I capital adequacy ratio is 25.68% against the minimum regulatory requirement of 5.50%. 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 and II 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.

***Quantitative disclosures:***

**Position of various risk weighted assets are presented below:**

| | 2015<br>BDT<br>Risk Weighted Assets | 2014<br>BDT<br>Risk Weighted Assets |
|---|---:|---:|
| On balance sheet items | 60,019,289,148 | 49,743,708,217 |
| Off balance sheet items | 23,319,786,924 | 28,385,480,903 |
| Total credit risk | 83,339,076,073 | 78,129,189,120 |
| Market risk | 2,314,206,301 | 5,351,178,658 |
| Operational risk | 19,356,043,488 | 18,010,378,799 |
| **Total risk weighted assets** | **105,009,325,862** | **101,490,746,577** |

**Detail of capital adequacy**

| | 2015<br>BDT | 2014<br>BDT |
|---|---|---|
| Capital requirement for credit risk | 8,333,907,607 | 7,812,918,912 |
| Capital requirement for market risk | 231,420,630 | 535,117,866 |
| Capital requirement for operational risk | 1,935,604,349 | 1,801,037,880 |
| **Total required capital** | **10,500,932,586** | **10,149,074,658** |
| Common Equity Tier I capital | 26,963,453,152 | N/A |
| Total Tier I capital | 26,963,453,152 | 21,994,863,641 |
| Total Tier II capital | 1,109,697,743 | 2,658,401,637 |
| **Total regulatory capital** | **28,073,150,895** | **24,653,265,278** |
| **Surplus** | **17,572,218,308** | **14,504,190,620** |
| **% of Capital adequacy required** | | |
| Common Equity Tier I | 4.50% | - |
| Tier I | 5.50% | 5% |
| Total | 10% | 10% |
| **% of Capital adequacy maintained** | | |
| Common Equity Tier I | 25.68% | - |
| Tier I | 25.68% | 21.67% |
| Total | 26.73% | 24.29% |

**5 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 Bank 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**

| | |
|---|---|
| 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.

***Quantitative disclosures:***

**Gross Credit Risk Exposure**

| | 2015<br>BDT | 2014<br>BDT |
|---|---|---|
| Claims on sovereigns and central banks | 15,460,497,007 | 16,474,275,386 |
| Claims on banks | 2,906,061,058 | 3,516,476,901 |
| Investments | 10,386,716,801 | 11,573,535,289 |
| Claims on corporate | 61,852,935,433 | 56,376,265,738 |
| Claims on consumer | 9,605,791,167 | 10,361,597,969 |
| Fixed assets | 459,847,362 | 455,956,480 |
| All other assets | 6,684,525,935 | 2,781,977,847 |
| Total on-balance sheet items | 107,356,374,763 | 101,540,085,610 |
| Off-balance sheet items (after considering the credit conversion factor) | 35,843,997,410 | 35,929,265,244 |
| **Total** | **143,200,372,173** | **137,469,350,854** |

**Geographical Distribution of Credit Exposure**

| 2015 | Dhaka | Chittagong | Sylhet | Total<br>BDT |
|---|---|---|---|---|
| Claims on sovereigns and central banks | 14,032,002,883 | 949,125,353 | 479,368,771 | 15,460,497,007 |
| Claims on banks | 2,906,061,058 | - | - | 2,906,061,058 |
| Investments | 10,383,850,101 | 2,756,200 | 110,500 | 10,386,716,801 |
| Claims on corporate | 53,958,008,404 | 7,894,927,029 | - | 61,852,935,433 |
| Claims on consumer | 7,660,404,999 | 1,582,369,600 | 363,016,569 | 9,605,791,167 |
| Fixed assets | 453,653,634 | 4,873,374 | 1,320,354 | 459,847,362 |
| All other assets | 6,680,439,678 | 4,002,757 | 83,500 | 6,684,525,935 |
| Total on-balance sheet items | 96,074,420,757 | 10,438,054,313 | 843,899,694 | 107,356,374,763 |
| Off-balance sheet items | 20,988,683,004 | 14,855,314,406 | - | 35,843,997,410 |
| **Total** | 117,063,103,761 | 25,293,368,719 | 843,899,694 | 143,200,372,173 |

| 2014 | Dhaka | Chittagong | Sylhet | Total<br>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 |

**Industry Distribution of exposures**

| 2015 | Banks & FIs BDT | Manufacturing BDT | Industry BDT | Retail BDT | Others BDT | Total BDT |
|---|---|---|---|---|---|---|
| Claims on sovereigns and central banks | 15,460,497,007 | - | - | - | - | 15,460,497,007 |
| Claims on banks | 2,906,061,058 | - | - | - | - | 2,906,061,058 |
| Investments | - | - | - | - | 10,386,716,801 | 10,386,716,801 |
| Claims on corporate | - | 26,452,447,457 | 27,785,712,111 | - | 7,614,775,865 | 61,852,935,433 |
| Claims on consumer | - | - | - | 9,605,791,167 | - | 9,605,791,167 |
| Fixed assets | - | - | - | - | 459,847,362 | 459,847,362 |
| **All other assets** | - | - | - | - | 6,684,525,935 | 6,684,525,935 |
| Total on-balance sheet items | 18,366,558,065 | 26,452,447,457 | 27,785,712,111 | 9,605,791,167 | 25,145,865,963 | 107,356,374,763 |
| Off-balance sheet items | 12,808,381,644 | - | - | - | 23,035,615,766 | 35,843,997,410 |
| **Total** | 31,174,939,709 | 26,452,447,457 | 27,785,712,111 | 9,605,791,167 | 48,181,481,729 | 143,200,372,173 |

| 2014 | Banks & FIs BDT | Manufacturing BDT | Industry BDT | Retail BDT | Others BDT | 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 |

**Maturity breakdown of credit exposures**

| 2015 | Within 1 month BDT | Within 1 to 3 months BDT | Within 3 to 12 months BDT | Within 1 to 5 years BDT | Over 5 years BDT | Total BDT |
|---|---|---|---|---|---|---|
| Claims on sovereigns and central banks | 12,638,826,179 | - | - | - | 2,821,670,828 | 15,460,497,007 |
| Claims on banks | 2,906,061,058 | - | - | - | - | 2,906,061,058 |
| Investments | 993,838,712 | 1,660,573,419 | 3,048,926,674 | 3,440,439,640 | 1,242,938,356 | 10,386,716,801 |
| Claims on corporate | 18,042,011,969 | 17,681,480,683 | 20,302,737,565 | 5,700,510,509 | 126,194,707 | 61,852,935,433 |
| Claims on consumer | 532,964,725 | 28,325,152 | 372,330,505 | 5,392,147,636 | 3,280,023,149 | 9,605,791,167 |
| Fixed assets | 10,851 | 2,251,929 | 23,114,016 | 325,512,052 | 108,958,514 | 459,847,362 |
| All other assets | 4,987,424,182 | 516,884,094 | 600,046,914 | 548,303,818 | 31,866,927 | 6,684,525,935 |
| Total on-balance sheet items | 40,101,137,676 | 19,889,515,278 | 24,347,155,674 | 15,406,913,655 | 7,611,652,481 | 107,356,374,763 |
| Off-balance sheet items | 4,066,142,012 | 10,818,785,508 | 10,881,786,668 | 10,077,283,222 | - | 35,843,997,410 |
| **Total** | 44,167,279,688 | 30,708,300,786 | 35,228,942,341 | 25,484,196,877 | 7,611,652,481 | 143,200,372,173 |

| 2014 | Within 1 month BDT | Within 1 to 3 months BDT | Within 3 to 12 months BDT | Within 1 to 5 years BDT | Over 5 years BDT | 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 |

| Gross Non Performing Assets (NPAs) | 2015 BDT | 2014 BDT |
|---|---|---|
| Non Performing Assets (NPAs) to outstanding loans and advances | 1,506,157,676 | 1,404,462,607 |

**Movement of NPAs**

| | 2015 BDT | 2014 BDT |
|---|---|---|
| Opening Balance | 1,404,462,607 | 1,345,055,443 |
| Written off during the period | (90,144,717) | (125,698,027) |
| Recoveries during the period | (314,438,695) | (374,117,460) |
| Addition during the period | 506,278,481 | 559,222,651 |
| Closing Balance | 1,506,157,676 | 1,404,462,607 |

**Movement of specific provision for NPAs**

| | 2015 BDT | 2014 BDT |
|---|---|---|
| Opening Balance | 418,953,210 | 457,926,415 |
| Written off (net off recovery) during the period | (6,095,090) | (41,049,798) |
| Recoveries during the period | (277,237,124) | (143,478,007) |
| Provision made during the period | 241,335,926 | 145,554,600 |
| Closing Balance | 376,956,922 | 418,953,210 |

## 6 Equities: Disclosures for banking book positions

The bank does not hold trading position in equities.

## 7 Interest rate risk in the banking books

Discussed in the next section under Market risk.

## 8 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 III. 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:**

| | 2015<br>BDT | 2014<br>BDT |
|---|---|---|
| Interest rate risk | 209,960,601 | 294,372,839 |
| Equity position risk | - | - |
| Foreign exchange risk | 21,460,029 | 240,745,027 |
| Commodity risk | - | - |
| | 231,420,630 | 535,117,866 |

## 9 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

- 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:***

| | 2015<br>BDT | 2014<br>BDT |
|---|---|---|
| Capital charge for operational risk | 1,935,604,349 | 1,801,037,880 |

**10 Liquidity Ratio**

***Qualitative disclosures:***

Liquidity Risk is the risk that the bank does not have sufficient financial resources to meet its obligations as they fall due or will have to do so at excessive cost. The risk arises from mismatch in the timing of cash flows.

The objective of liquidity framework is to allow the Bank to withstand very severe stresses. It is designed to be adaptable to change the business modes, markets and regulators. The liquidity risk management frameworks requires:

- liquidity to managed by Bank on stand-alone basis with no reliance on the Bangladesh Bank;
- to comply with all regulatory limits;
- to maintain positive stressed cash flow;
- monitoring the contingent funding commitments;
- monitoring the structural term mismatch between maturing assets and liabilities;
- maintenance of robust and practical liquidity contingency plan;
- maintain diverse sources of funding and adequate back up lines.

Liquidity management of the Bank is centered on the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) based on BASEL III. The Bank has Asset Liability Management (ALM) desk to manage this risk with active monitoring and management from Global Markets Department.

The Bank has adopted Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) for liquidity risk management. LCR ensures that banks maintain enough high quality unencumbered liquid assets to meet its liquidity needs for 30 calendar time-line whereas NSFR ensures availability of stable funding is greater than required funding over 1 year period.

Bank has Asset Liability Management Committee (ALCO) to monitor the liquidity risk on a monthly basis. Based on the detail recommendation from ALM desk, ALCO take appropriate action to manage the liquidity risk. To have more conservative approach towards liquidity risk measurement, the Bank has set internal LCR and NSFR limits which are more stringent and set higher than the regulatory limit of 100%. These ratios are regularly monitored at ALCO. Also Bank has internal risk control framework which outlines clear and consistent policies and principles for liquidity risk management.

| ***Quantitative disclosures:*** | 2015<br>BDT |
|---|---|
| Liquidity coverage ratio (%) | 82.20% |
| Net Stable Funding Ratio (%) | 100.10% |
| Stock of High quality liquid assets | 47,929,751,542 |
| Total net cash outflows over the next 30 calendar days | 58,310,611,079 |
| Available amount of stable funding | 104,421,897,173 |
| Required amount of stable funding | 104,316,890,547 |

## 11 Leverage Ratio

***Qualitative disclosures:***

Leverage ratio is the ratio of tier 1 capital to total on and off-balance sheet exposures. The leverage ratio was introduced into the Basel III framework as a non-risk based backstop limit, to supplement risk-based capital requirements.

In order to avoid building-up excessive on and off-balance sheet leverage in the banking system, a simple, transparent, non-risk based leverage ratio has been introduced by the Bangladesh Bank. The leverage ratio is calibrated to act as a credible supplementary measure to the risk based capital requirements. The leverage ratio is intended to achieve the following objectives:

- constrain the build-up of leverage in the banking sector which can damage the broader financial system and the economy; and
- reinforce the risk based requirements with an easy to understand and a non-risk based measure.

The Bank has calculated the regulatory leverage ratio as per the guideline of Basel III. The numerator, capital measure is calculated using the new definition of Tier I capital applicable from 01 January 2015. The denominator, exposure measure, is calculated on the basis of the Basel III leverage ratio framework as adopted by the Bangladesh Bank. The exposure measure generally follows the accounting value, adjusted as follows:

- on-balance sheet, non derivative exposures are included in the exposure measure net of specific provision;
- physical or financial collateral is not considered to reduce on-balance sheet exposure;
- loans are not netted with deposits;
- off balance sheet items are converted into credit exposure equivalents through the use of credit conversion factors (CCFs). Depending on the risk category of the exposure a CCF of 20%, 50% or 100% is applied. Commitments that are unconditionally cancellable at any time by the bank without prior notice, a CCF of 10% is applied;
- item deducted from Tier I capital such as deferred tax assets is excluded.

| ***Quantitative disclosures:*** | **2015**<br>**BDT** |
|---|---|
| Leverage ratio | 14.17% |
| On balance sheet exposure | 140,478,982,531 |
| Off balance sheet exposure | 50,121,981,860 |
| Total exposure | 190,600,964,391 |

## 12 Remuneration

***Qualitative disclosures:***

The Bank has a Group specified remuneration policy which is designed 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 HSBC and performing their role in the long-term interests of shareholders. The Group Remuneration Committee oversees the remuneration policy and are responsible for setting the overarching principles, parameters and governance framework of the remuneration policy. All members of the Committee are independent non-executive Directors of HSBC Holdings plc. The Committee periodically reviews the adequacy and effectiveness of the Group's remuneration policy and ensures that the policy meets the commercial requirement to remain competitive, is affordable, allows flexibility in response to prevailing circumstances and is consistent with effective risk management.

HSBC's reward package consists of the following key elements:

**Fixed Pay:**

The purpose of the fixed pay is to attract and retain employees by paying market competitive pay for the role, skills and experience required for the business. This includes salary, fixed pay allowance, and other cash allowances in accordance with local market practices. These payments are fixed and do not vary with performance.

**Benefits:**

HSBC provides benefits in accordance with local and international market practice. This includes but is not limited to the provision of pensions, medical insurance, life insurance, and relocation allowances etc.

**Annual Incentive:**

HSBC provides annual incentive to drive and reward performance based on annual financial and non-financial measures consistent with the medium to long-term strategy, shareholder interests and adherence to HSBC values. Awards can be in the form of cash and shares. A portion of the annual incentive award is deferred and vests over a period of 3 years. The Bank pays the incentive in the form of cash.
Key features of HSBC's remuneration framework include:

- assessment of performance with reference to clear and relevant objectives set within a performance scorecard framework;

- a focus on total compensation (fixed plus variable pay) with variable pay (namely annual incentive and the value of long term incentives) differentiated by performance and adherence to HSBC values;

- the use of discretion to assess the extent to which performance has been achieved; and

- deferral of a significant proportion of variable pay into HSBC shares to tie recipients to the future performance of the Group and align the relationship between risk and reward.

Within this framework, risk alignment of our remuneration structure is achieved through the following measures:

- Risk and compliance is a critical part of the assessment process in determining the performance of all employees, especially senior executives and identified staff and material risk takers. All employees are required to have risk measures in their performance scorecards, which ensure that their individual remuneration has been appropriately assessed with regard to risk.

- Adherence to HSBC values is a pre-requisite for any employee to be considered for variable pay. HSBC values are key to the running of a sound, sustainable bank. Employees have a separate HSBC values rating which directly influences their overall performance rating considered by the Committee for their variable pay determinations.

- For our most senior employees, the greater part of their reward is deferred and thereby subject to malus, which allows the awards to be reduced or cancelled if warranted.

- The Group also carries out regular reviews to assess instances of non-compliance with risk procedures and expected behaviour. Instances of non-compliance are escalated for consideration in variable pay decisions, including adjustments and malus of unvested awards granted in prior years. For identified staff and Material Risk Takers (MRTs), the Committee has oversight of such decisions.

- All variable pay awards made to identified staff and material risk takers for the performance year in which they have been identified as MRTs are also subject to the Group Clawback Policy in accordance with the requirements in the Prudential Regulation Authority's Remuneration Code.

***Quantitative disclosures:***

| | 2015 (BDT) |
|---|---|
| Number of meetings held by the main body overseeing remuneration during the financial year | n/a |
| Remuneration paid to the main body overseeing remuneration during the financial year | n/a |
| Number of employees having received a variable remuneration award during the financial year | 812 |

Guaranteed bonuses awarded during the financial year:

| | |
|---|---|
| Number of employee | 896 |
| Total amount of guaranteed bonuses | 72,630,798 |

Sign-on awards made during the financial year:

| | |
|---|---|
| Number of employee | 1 |
| Total amount of sign-on awards | 2,000,000 |

Severance payments made during the financial year:

| | |
|---|---|
| Number of employee | - |
| Total amount of severance payments | - |

| | |
|---|---|
| Total amount of outstanding deferred remuneration (in cash) | 15,796,947 |
| Total amount of deferred remuneration paid out in the financial year | 6,587,382 |

Breakdown of amount of remuneration awards for the financial year:

| | |
|---|---|
| Fixed and variable | 1,628,411,039 |
| Variable pay | |
| Deferred | 4,519,824 |
| Non-deferred | 357,933,491 |
| | 362,453,315 |