



## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

### Contents

<b>Introduction</b> .....	2
Basel II .....	2
Future Developments .....	2
Pillar 3 disclosures 2013 .....	4
Consolidation basis .....	5
Scope of Basel II permissions .....	5
<b>Capital</b> .....	7
Regulatory Capital .....	7
<b>Operational risk, credit risk and market risk</b> .....	8
Internal assessment of capital adequacy .....	9
<b>Terms and conditions of capital securities</b> .....	13
Tier 1 capital .....	13
Preference shares and related premium .....	13
Hybrid capital securities .....	14
Tier 2 capital .....	14
<b>Glossary</b> .....	16
<b>Tables</b>	
Table 1 Capital structure at 31 December .....	7
Table 2 Operational risk capital requirements .....	8
Table 3 Credit risk capital requirements .....	8
Table 4 Market risk capital requirements .....	9

### Presentation of Information

This document comprises the *Capital and Risk Management Pillar 3 Disclosures at 31 December 2013* ('Pillar 3 Disclosures 2013') for HSBC Bank plc ('the bank') and its subsidiary undertakings (together 'the group'). References to either 'HSBC' or 'the Group' within this document mean HSBC Holdings plc together with its subsidiaries.

### Cautionary Statement Regarding Forward Looking Statements

These *Pillar 3 Disclosures 2013* contain certain forward-looking statements with respect to the financial condition, results of operations and business of the group. Statements that are not historical facts, including statements about the group's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible', variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made. The bank makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statement.

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ materially from those anticipated or implied in any forward-looking statement.

### Frequency

In accordance with the Prudential Regulation Authority of the United Kingdom ('PRA') requirements, the bank publishes its Pillar 3 disclosures annually.

### Verification

The *Pillar 3 Disclosures 2013* have been verified internally but have not been audited by the group's external auditor.

### Media and Location

The HSBC Holdings plc Pillar 3 Disclosures 2013 and other information on the Group are available on HSBC's investor relations website: [www.hsbc.com/investor-relations](http://www.hsbc.com/investor-relations).

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

### Introduction

The bank is a subsidiary of HSBC Holdings plc. HSBC is one of the largest banking and financial services organisations in the world, with a market capitalisation of US\$ 207 billion at 31 December 2013.

The group provides a comprehensive range of banking and related financial services and divides its activities into four business segments: UK Retail Banking, Continental Europe Retail Banking, Global Banking and Markets, and Global Private Banking.

Further details of the group's principal activities can be found on page 13 of the HSBC Bank plc *Annual Report and Accounts 2013* ('2013 Accounts').

### Basel II

HSBC is supervised on a consolidated basis in the UK where, on 1 April 2013, three new regulatory bodies were established: the Financial Policy Committee ('FPC') of the Bank of England ('BoE'), the PRA and the Financial Conduct Authority ('FCA').

As the PRA supervises HSBC on a consolidated basis, it receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. Individual banking subsidiaries are directly regulated by their local banking supervisors, including the PRA itself in certain circumstances (for example, the bank), who set and monitor their local capital adequacy requirements.

At consolidated group and bank level, capital was calculated for prudential regulatory reporting purposes throughout 2013 using the Basel II framework of the Basel Committee on Banking Supervision ('Basel Committee'), as implemented by the European Union ('EU') in the (amended) Capital Requirements Directive, and subsequently by the Financial Services Authority ('FSA') and, latterly, the PRA in their rulebooks for the UK banking industry.

The Basel II framework, which is structured around three 'pillars': minimum capital requirements, supervisory review and market discipline, has been updated by the Basel Committee in Basel III, which in the EU has been implemented with legal effect from 1 January 2014 through a Directive and a Regulation ('CRD IV') which together supersede earlier Directives. Significant matters within the scope of CRD IV include the quality and quantity of regulatory capital, the calculation of capital requirements for major risk types, liquidity and funding, capital buffers and leverage.

The local regulators of Group banking entities outside the EU are at varying stages of implementation of the Basel framework and local reporting in 2013 may still have been on a Basel I basis in some places. In most jurisdictions, non-banking financial institutions are also

subject to the supervision and capital requirements of local regulatory authorities.

### Future Developments

Unless otherwise stated, the developments noted below represent forward looking statements and reflect management's expectation of future regulatory developments following the period covered by this report.

### CRD IV

Commencing 1 January 2014, the CRD IV rule changes introduce a revised definition of regulatory capital, primarily focused on common equity tier 1 ('CET1') capital as the predominant form of going concern capital, with a greater quantum to be held by banks. There are increased capital deductions and new regulatory adjustments affecting this higher tier of capital. The new rules also introduce increased RWA requirements, mainly for Counterparty Credit Risk ('CCR'). The most significant impacts on CET1 capital are the proposed deduction of equity holdings in banks, financial institutions and insurance entities and the excess of expected losses over impairment allowances resulting in a reallocation of current deductions to this higher tier of capital and new rules for calculating the amounts to be deducted and the introduction of an additional valuation adjustment of balance sheet positions measured at market or fair value using specified standards for prudent valuation.

CRD IV also requires banks to maintain a number of additional capital buffers to be met by CET1 capital. These new capital requirements include a Capital Conservation Buffer designed to ensure banks build up capital outside periods of stress that can be drawn down when losses are incurred, currently set at 2.5 per cent, and an institution specific Countercyclical Capital Buffer ('CCB'), to protect against future losses where unsustainable levels of leverage, debt or credit growth pose a systemic threat. Additionally, CRD IV set out a Systemic Risk Buffer ('SRB') for the banking system as a whole to mitigate structural macro-prudential risk. If applicable, the SRB will be set at a minimum of 1 per cent. The Capital Conservation Buffer and the CCB are to be phased in subject to national transposition in the UK.

The most significant impact on RWAs is a new capital charge to cover risk of mark to market losses on expected counterparty risk, referred to as a regulatory credit valuation adjustment ('CVA') risk capital charge, calculated on a full range of over the counter ('OTC' - i.e. non-exchange traded) derivative counterparties. Other changes will impose increases in the asset value correlation multiplier for financial counterparties, additional requirements for collateralised counterparties,

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

margin period of risk and new requirements for exposures to central clearing counterparties resulting in a higher CCR charge. Under CRD IV, the final calibration and legislative proposal for a leverage ratio are expected to be determined following a review of the revised Basel Committee proposals and the basis of the EBA's assessment of the impact and effectiveness of the leverage ratio during a monitoring period from 1 January 2014 until 30 June 2016. In December 2013, the PRA issued its final rules on CRD IV in a Policy Statement PS 7/13. This transposes the various areas of national discretion within the final CRD IV legislation into UK law. Whilst CRD IV allows for the majority of regulatory adjustments and deductions from CET1 to be implemented on a gradual basis from 1 January 2014 to 1 January 2018, the PRA's transposition of the national discretions does not make use of those transitional provisions.

Despite final PRA rules uncertainty remains around the precise amount of capital that banks will be required to hold. This relates to the quantification and interaction of capital buffers and Pillar 2. In addition, many Technical Standards and guidelines have been issued by the EBA in draft form for consultation or are pending publication in 2014. These must be adopted by the European Commission for them to become legally enforceable. This provides further uncertainty as to the precise capital requirements under CRD IV.

In December 2013, the EBA published a draft final consultation on the Regulatory Technical Standard for 'Own Funds – Part III' which elaborates on the capital calculation of holdings of common equity instruments of financial sector entities. This is currently under review and may have a material impact on our capital position.

### Other Regulatory Proposals

The ability of banks' internal models to adequately capture the risk of a portfolio has been an on-going area of regulatory focus. During 2013, the PRA proposed a framework to UK banks to be applied in assessing low default wholesale portfolios. This framework will impose loss given default ('LGD') and exposure at default ('EAD') floors based on the foundation approach for portfolios with less than 20 events of default (per country). In December 2013, the PRA confirmed that floors would be implemented across two portfolios by the end of March 2014.

In December 2013, the PRA issued its Supervisory Statement SS13/13 in relation to Market Risk. This requires banks to identify risks not adequately captured by models and to hold additional funds against these risks under its Risks not in VAR ('RNIV') framework. In assessing these risks, no offsetting or diversification will be allowed across risk factors. To align with this

requirement, the group is currently reviewing and revising its methodology.

In October 2013, the Bank of England published a discussion paper 'A framework for stress testing the UK banking system'. The framework replaces the current stress testing for the Pillar 2 capital planning buffer ('the PRA buffer') with annual concurrent stress tests, the results of which are expected to inform the setting of the PRA buffer, the CCB, the SCR and other FPC recommendations to the PRA. The PRA is expected to further consult on Pillar 2 in 2014. Until outstanding consultations are published and guidance issued, there remains uncertainty as to the interaction between these buffers, the exact buffer requirements and what, if any, will be the final capital impact.

### UK Regulatory Reform

The UK financial services regulatory structure has undergone substantial reform following the abolition of the FSA and establishment of three new regulatory bodies from 1 April 2013. These three bodies comprise the FPC, the PRA and the FCA. The bank is a 'dual-regulated' firm, subject to prudential regulation by the PRA and to conduct regulation by the FCA. These reforms have also provided the new regulatory bodies with additional powers.

The FPC has been granted powers to give directions to the FCA or the PRA on the exercise of their supervisory powers, and may make recommendations within the BoE, to HM Treasury, to the FCA or the PRA or to 'other persons'.

From 2014 the FPC is also responsible for decisions on the countercyclical capital buffer ('CCB'), a CRD IV requirement, to be applied to certain financial institutions. The CCB is a macro-prudential tool at the disposal of national authorities that can be deployed when the FPC judges that threats to financial stability have arisen in the UK increasing system-wide risk, and to protect the banking sector from future potential losses. Should a CCB be required, it is expected that the additional capital required would be in the range of 0-2.5 per cent of risk-weighted assets, although national supervisors have powers under CRD IV to increase this capital add-on.

In addition, the FPC has been granted direction power, under the new legislation, over sectoral capital requirements ('SCR's). The SCR tool would allow the FPC to change capital requirements above minimum regulatory standards on exposures held by all UK banks to three broad sectors judged to pose a risk to the system as a whole (residential property, including mortgages; commercial property; and exposures to the financial sector), as well as more granular sub-sectors (for example, to mortgages with high loan-to-value or loan-to-income ratios at origination). This will include both

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

banking book and trading book exposures and ignores the domicile of the ultimate borrower.

The CCB and SCR tools are stated as broad tools designed to reduce the likelihood and severity of financial crises, the primary purpose being to tackle cyclical risks. Both tools provide the FPC with means to increase the amount of capital that banks are required to hold when threats to financial stability are judged to be emerging. The amount of capital add-ons for SCR has not yet been quantified.

### Structural Banking Reform

In December 2013, the UK's Financial Services (Banking Reform) Act 2013 received Royal Assent, becoming primary legislation. It implements the recommendations of the Independent Commission on Banking and of the Parliamentary Commission on Banking Standards, which inter alia establishes a framework for 'ring-fencing' the UK retail banking from wholesale banking activities and sets out requirements for greater capacity for absorbing loss. A consultation has also taken place on draft secondary legislation setting out further details of the implementation but the underlying rules from supervisory authorities are not yet available. The UK government intends to complete the legislative and rule-making process by the end of this Parliament in May 2015 and to have reforms in place by 2019.

In January 2014, following a consultation period, the European Commission published its own legislative proposals on the structural reform of the European banking sector which would ban proprietary trading in financial instruments and commodities, and enable supervisors to require trading activities such as market-making, complex derivatives and securitisation operations to be undertaken in a separate subsidiary from deposit taking activities. The ring-fenced deposit taking entity would be subject to separation from the trading entity including capital and management structures, issuance of own debt and arms-length transactions between entities. The proposals allow for derogation from these requirements for super-equivalent national regimes but it is not currently clear if the UK laws will qualify for this treatment. On the current basis, it is understood that non-EU subsidiaries of the group which could be separately resolved without a threat to the financial stability of the EU would be excluded from the proposals. The proposals will now be subject to discussion in the European Parliament and the Council of Ministers (representing the EU member states) and are not expected to be finalised in 2014. The implementation date for any separation under the final rules would depend upon the date on which the final legislation is agreed. The group continues to monitor these developments.

### RWA Integrity

In July 2013, the Basel Committee published its findings on the 'Analysis of risk-weighted assets for credit risk in the banking book', reporting that while the majority of RWA variability arises from the underlying credit quality of a portfolio, differences also arise from banks' choices under the IRB approach. One of its recommendations to counteract this variance was the introduction of new or increased capital floors.

In parallel with the above and as part of the review of the Basel capital framework, also in July 2013, the Basel Committee published a discussion paper on its findings, 'The regulatory framework: balancing risk sensitivity, simplicity and comparability'. The Basel Committee proposed that a range of measures should be considered, including the possibility of additional floors, as a potential tool to constrain the effect of variation in RWAs derived from internal model outputs, to provide further comfort that banks' risks are adequately capitalised and to make capital ratios more comparable.

In November 2013, the FPC postponed a decision on whether to propose parallel RWA disclosures by UK banks on the Basel standardised approach, pending further assessment by the PRA of the merits, cost and benefits of such a proposition.

In December 2013, the EBA published the final results of its investigation into RWAs in the banking book, aimed at identifying any material difference in RWA outcomes between banks and understanding the sources of such differences. The report concluded that differences in implementation of the IRB approach were linked to differences in practice on the part of both supervisors and banks. The EBA set out a number of policy recommendations to address its findings. These include enhancing the disclosure and transparency of RWA-related information, supporting supervisors in properly implementing the single rulebook with the delivery of existing mandates set out in CRD IV and developing additional guidance that specifically addresses and facilitates consistency in supervisory and bank practice. We are reviewing these proposals.

### Pillar 3 disclosures 2013

Pillar 3 complements the minimum capital requirements and the supervisory review process. Its aim is to encourage market discipline by developing a set of disclosure requirements which allow market participants to assess certain specified information on: the scope of application of Basel II, capital, particular risk exposures and risk assessment processes, and hence the capital adequacy of the institution. Disclosures consist of both quantitative and qualitative information and are provided at the consolidated level.

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

Banks are required to disclose all their material risks as part of the pillar 3 framework. All material and non-proprietary information required by pillar 3 is included in the HSBC Holdings plc *Pillar 3 Disclosures 2013*. HSBC Bank plc, as a significant subsidiary of HSBC Holdings plc, is required to publish certain limited pillar 3 disclosures separately on a consolidated basis.

The PRA permits certain pillar 3 requirements to be satisfied by inclusion within a firm's financial statements. Where this is the case, this document provides page references to the relevant sections in the HSBC Bank plc *2013 Accounts* and HSBC Holdings plc *Annual Report and Accounts 2013*.

### Movement in risk-weighted assets in 2013

During 2013, the group's risk-weighted assets ('RWA') reduced by £7 billion to £186 billion due to movements in credit and market risk. Credit risk RWA fell by £4 billion, primarily as a result of reduced securitisation exposures and updates to methodology and regulatory policy in the calculation of corporate and commercial customer RWA. Market risk RWA declined by £4 billion primarily through lower risk levels following reductions in exposures and improvements in market conditions.

The impact of these changes is visible in Tables 1, 3 & 4 on pages 8-10 of these *Pillar 3 Disclosures 2013*.

### Comparison with the HSBC Bank plc *Annual Report and Accounts 2013*

The *Pillar 3 Disclosures 2013* have been prepared in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with International Financial Reporting Standards ('IFRS'). Therefore, some information in the *Pillar 3 Disclosures 2013* is not directly comparable with the financial information in the HSBC Bank plc *2013 Accounts*. This is most pronounced for the credit risk disclosures, where credit exposure is defined as the amount estimated to be at risk under specified Basel II parameters. This differs from similar information in the HSBC Bank plc *2013 Accounts*, which is mainly reported at the balance sheet date and therefore does not reflect the likelihood of future drawings of committed credit lines.

### Consolidation basis

The basis of consolidation for financial accounting purposes is described in *Note 1 - Basis of preparation* of the notes on the financial statements on page 103 of the HSBC Bank plc *2013 Accounts*. This differs from that used for regulatory purposes. Investments in banking associates are equity accounted in the financial accounting consolidation, whereas their exposures are proportionally consolidated for regulatory purposes. Subsidiaries and associates engaged in insurance and non-financial activities are excluded from the regulatory

consolidation and are deducted from regulatory capital. The regulatory consolidation does not include Special Purpose Entities ('SPEs') where significant risk has been transferred to third parties. Exposures to these SPEs are either risk-weighted as securitisation positions or deducted from capital for regulatory purposes.

### Scope of Basel II permissions

The Basel II framework has been updated by the Basel Committee in Basel III, which in the EU has been implemented with legal effect from 1 January 2014 through a Directive and a Regulation ('CRD IV') which together supersede earlier Directives. Significant matters within the scope of CRD IV include the quality and quantity of regulatory capital, the calculation of capital requirements for major risk types, liquidity and funding, capital buffers and leverage.

In December 2013, the PRA issued final rules implementing CRD IV in the UK. In summary, these deploy available national discretion in order to accelerate significantly the transition timetable to full 'end-point' CRD IV compliance.

Important elements of the capital adequacy framework in the UK have yet to be clarified, and uncertainties remain around the amount of capital that banks will be required to hold. These include the quantification and interaction of capital buffers and the definitions of several significant adjustments to regulatory capital. In addition, many Technical Standards and guidelines have been issued by the European Banking Authority ('EBA') in draft form for consultation or are pending publication in 2014. These are due for adoption by the European Commission to become legally enforceable.

### 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, trade finance and leasing business, but also from off-balance sheet products such as guarantees and credit derivatives, and from the group's holdings of debt and other securities.

Basel II applies three approaches of increasing sophistication to the calculation of minimum credit risk capital requirements. The most basic, the standardised approach, requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties, to group unrated counterparties into broad categories and to apply standardised risk weightings. The next level, the internal ratings-based ('IRB') foundation approach, allows banks to calculate their credit risk capital requirements on the basis of their internal assessment of the probability that a counterparty will default ('PD'), but uses supervisory formulae and

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

parameters to estimate exposure at default ('EAD') and loss given default ('LGD'). Finally, the IRB advanced approach allows banks to use their own internal assessment in both determining PD and quantifying EAD and LGD.

The capital resources requirement, which is intended to cover unexpected losses, is derived from formulae specified in the regulatory rules which incorporate these factors and other variables such as maturity and correlation. Expected losses under the IRB approaches are calculated by multiplying PD by EAD and LGD. Expected losses are deducted from capital to the extent that they exceed accounting impairment allowances on the IRB portfolios.

For credit risk, with the PRA's approval, the group has adopted the IRB advanced approach for the majority of its business, with the remainder on either IRB foundation or standardised approaches. A rollout plan is in place to extend coverage of the advanced approach over the next few years, leaving a residue of exposures on the standardised approach.

The environment for approval and operation of internal risk-based ('IRB') analytical models remains challenging. During 2013, the PRA introduced a number of measures to constrain modelling approaches used to calculate RWAs; these generally have driven higher capital requirements. These measures included a 45% floor for LGD on sovereign IRB exposures and a requirement to adopt supervisory slotting for certain commercial real estate exposures. Given that the majority of European Economic Area ('EEA') sovereign exposures are treated under the standardised approach, the new LGD floor effectively only applies to non-EEA sovereign exposures. In December 2013, the PRA confirmed that further floors were to apply to two portfolios by the end of March 2014. The PRA has indicated that other low default wholesale portfolios will be subject to similar floors beginning in 2014.

As part of the introduction of the Capital Requirements Regulation firms are also required to apply for a renewed permission to use the IRB approach to credit risk. Under these requirements firms are required to attest that their risk rating system complies with the requirements of the CRR and its IRB Supervisory Statement (SS11/13) issued in December 2013. Where a firm is unable to demonstrate full compliance they may be subject to the imposition of additional regulatory floors or required to revert to less advanced approaches for the affected portfolio(s). As a result of these requirements, three portfolios reverted from an AIRB to a standardised approach in January 2014 and a further two are expected to revert from AIRB to FIRB in January 2015.

### Counterparty credit risk

Counterparty credit risk is the risk that the counterparty to a transaction may default before completing the satisfactory settlement of the transaction. It arises on OTC and securities financing transactions in both the trading and non-trading books.

Three methods for determining exposure values are defined by Basel II: standardised, mark-to-market and internal model method. These exposure values are used to determine capital requirements under one of the credit risk approaches: standardised, IRB foundation and IRB advanced.

The group uses the mark-to-market and internal model methods to measure exposure for counterparty credit risk. Its longer-term aim is to migrate more positions to the internal model method.

### 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 the group's income or the value of its portfolios. Market risk is measured using internal market risk models where approved by the PRA, or the PRA's standard market risk position risk requirement ('PRR') rules.

Following the implementation of CRD III, the bank's internal market risk models comprise models for Value at Risk ('VAR'), stressed VAR and the incremental risk charge.

The group uses both approaches for market risk. Its longer-term aim is to migrate more positions from standard market risk PRR rules to internal models based approaches.

### Operational risk

Basel II includes capital requirements for operational risk, again utilising three levels of sophistication. The capital required under the basic indicator approach is a simple percentage of gross revenues, whereas under the standardised approach it is one of three different percentages of gross revenues allocated to each of eight defined business lines. Both these approaches use an average of the last three financial years' revenues. Finally, the advanced measurement approach uses a bank's own statistical analysis and modelling of operational risk data to determine capital requirements.

The group has adopted the standardised approach in determining its operational risk capital requirements, although it is working towards developing and agreeing an operational risk capital model that could be used to support a waiver to adopt the advanced measurement approach at a future date.

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

### Capital

#### Regulatory capital

Table 1 below sets out the composition of the group's regulatory capital and risk-weighted assets at 31 December 2013.

Table 1: Capital structure at 31 December<sup>1</sup>

	2013 £m	2012 £m
<b>Composition of regulatory capital (Audited)</b>		
Shareholders' equity <sup>2</sup>	31,992	31,840
Shareholders' equity per balance sheet	32,370	31,675
Preference shares & related premium	(431)	(431)
Other equity instruments	-	-
Deconsolidation of special purpose entities <sup>3</sup>	53	596
Non-controlling interests	399	375
Non-controlling interests per balance sheet	549	525
Of which representing non-controlling interests in preference shares	(150)	(150)
Regulatory adjustments to the accounting basis	(1,388)	(1,833)
Unrealised (gains)/losses on available-for-sale debt securities <sup>4</sup>	(451)	(163)
Own credit spread	218	89
Defined benefit pension fund adjustment <sup>5</sup>	(946)	(1,219)
Cash flow hedging reserve	13	(259)
Reserves arising from revaluation of property & unrealised gains on available-for-sale equities	(221)	(226)
Other regulatory adjustments	(1)	(55)
Deductions	(8,565)	(8,294)
Goodwill capitalised & intangible assets	(7,218)	(7,107)
50% of securitisation positions	(902)	(922)
50% of excess expected losses over impairment allowances	(477)	(288)
50% of tax credit adjustment for excess expected losses	32	23
<b>Core tier 1 capital</b>	<b>22,438</b>	<b>22,088</b>
Other tier 1 capital before deductions	2,353	2,363
Preference shares & related premium	581	581
Hybrid capital securities	1,772	1,782
Deductions	(683)	(434)
Unconsolidated investments <sup>6</sup>	(715)	(457)
50% of tax credit adjustment for excess expected losses	32	23
<b>Tier 1 capital</b>	<b>24,108</b>	<b>24,017</b>
Total qualifying tier 2 capital before deductions	11,582	11,634
Reserves arising from unrealised gains on revaluation of property & available-for-sale equities	221	226
Collective impairment allowances <sup>7</sup>	139	271
Perpetual subordinated debt	2,683	2,743
Term subordinated debt	8,539	8,394
Total deductions other than from tier 1 capital	(2,147)	(2,187)
Unconsolidated investments <sup>6</sup>	(715)	(971)
50% of securitisation positions	(902)	(922)
50% of excess expected losses over impairment allowances	(477)	(288)
Other deductions	(53)	(6)
<b>Total Regulatory capital</b>	<b>33,543</b>	<b>33,464</b>
<b>Risk-weighted assets (Unaudited)</b>		
Credit and counterparty credit risk	145,909	149,970
Market risk	17,931	21,566
Operational risk	22,039	21,866
<b>Total</b>	<b>185,879</b>	<b>193,402</b>
<b>Capital ratios (Unaudited)</b>	<b>%</b>	<b>%</b>
Core tier 1 ratio	12.1	11.4
Tier 1 ratio	13.0	12.4
Total capital ratio	18.0	17.3

#### Notes

<sup>1</sup> Based on Basel II requirements.

<sup>2</sup> Includes externally verified profits for the year to 31 December 2013. Does not include the interim dividend of £630m declared by the Board of Directors after 31 December 2013.

<sup>3</sup> Mainly comprises unrealised losses on available-for-sale debt securities owned by deconsolidated special purpose entities.

<sup>4</sup> Under PRA rules unrealised gains/losses on available-for-sale debt securities must be excluded from capital resources.

<sup>5</sup> PRA rules require banks to exclude from capital resources any surplus in a defined benefit pension scheme.

<sup>6</sup> Mainly comprise investments in insurance entities.

<sup>7</sup> Under PRA rules collective impairment allowances on loan portfolios under the standardised approach may be included in tier 2 capital.



## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

### Operational risk, credit risk and market risk

Tables 2, 3 & 4 below set out the group's operational, credit and market risk-weighted assets and regulatory capital requirements at 31 December 2013.

*Table 2: Operational risk capital requirements*

	At 31 December 2013		At 31 December 2012	
	Capital required £m	RWA £m	Capital required £m	RWA £m
<b>Operational risk analysis by approach</b>				
Standardised approach .....	1,763	22,039	1,749	21,866

*Table 3: Credit risk capital requirements*

	At 31 December 2013		At 31 December 2012	
	Capital required £m	RWA £m	Capital required £m	RWA £m
<b>Total credit risk capital requirements</b>				
Credit risk .....	10,357	129,459	10,712	133,898
Counterparty credit risk <sup>1</sup> .....	1,316	16,450	1,286	16,072
<b>Total</b> .....	<b>11,673</b>	<b>145,909</b>	<b>11,998</b>	<b>149,970</b>
<b>Credit risk analysis by exposure class</b>				
Exposures under the IRB advanced approach .....	7,538	94,222	6,899	86,234
Retail:				
– secured on real estate property .....	451	5,639	477	5,958
– qualifying revolving retail .....	381	4,761	422	5,281
– small and medium-sized enterprises .....	410	5,122	315	3,934
– other retail .....	380	4,754	391	4,893
Total retail .....	1,622	20,276	1,605	20,066
Central governments and central banks .....	248	3,103	162	2,031
Institutions .....	388	4,855	344	4,298
Corporates .....	4,366	54,571	3,533	44,160
Securitisation positions <sup>2</sup> .....	914	11,417	1,235	15,433
Equity <sup>3</sup> .....	-	-	20	246
Exposures under the IRB foundation approach .....	478	5,937	351	4,393
Corporates .....	478	5,937	351	4,393
Exposures under the Standardised approach .....	2,344	29,300	3,462	43,271
Institutions .....	171	2,132	116	1,449
Corporates .....	1,178	14,731	2,285	28,568
Retail .....	293	3,663	278	3,470
Secured on real estate property .....	108	1,350	225	2,818
Past due items .....	42	530	37	461
Equity .....	75	941	45	557
Items belonging to regulatory high risk categories .....	36	454	11	132
Other items <sup>4</sup> .....	440	5,499	465	5,816
<b>Total</b> .....	<b>10,357</b>	<b>129,459</b>	<b>10,712</b>	<b>133,898</b>

#### Notes

- <sup>1</sup> Includes counterparty credit risk on both trading book and non-trading book exposures. Counterparty credit risk RWA on non-trading book exposures totalled £1.1bn at 31 December 2013 and less than £0.1bn at 31 December 2012.
- <sup>2</sup> Excludes securitisation positions deducted from capital (which would otherwise be risk-weighted at 1,250 per cent). Securitisation positions deducted from capital are shown in Table 2.
- <sup>3</sup> These holdings represent venture capital exposures risk-weighted using the equity IRB simple risk weight approach.
- <sup>4</sup> Primarily includes items such as tangible fixed assets, prepayments and deferred taxation as well as immaterial exposure classes under the standardised approach.

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

Table 4: Market risk capital requirements

	At 31 December 2013		At 31 December 2012	
	Capital required £m	RWA £m	Capital required £m	RWA £m
<b>Market risk analysis by approach</b>				
Internal models based requirements	1,226	15,326	1,554	19,427
VAR	193	2,415	327	4,089
Stressed VAR	232	2,897	475	5,940
Incremental Risk Charge	379	4,736	278	3,472
Other VAR and stressed VAR <sup>1</sup>	422	5,278	474	5,926
Standard market risk position risk requirements <sup>2</sup>	208	2,605	171	2,139
Interest rate position risk requirement	110	1,375	98	1,229
Securitisation position risk requirement	91	1,138	65	814
Equity position risk requirement	3	38	-	1
Commodity position risk requirement <sup>3</sup>	4	51	7	81
Foreign exchange position risk requirement	-	-	-	-
CIU position risk requirement	-	3	1	14
<b>Total market risk capital requirement</b>	<b>1,434</b>	<b>17,931</b>	<b>1,725</b>	<b>21,566</b>

### Notes

- These are results from countries which cannot be included in the consolidated results because regulatory permission to do so has not been received, and which must therefore be aggregated rather than consolidated.
- Calculated using PRA standard market risk PRR rules.
- At 31 December 2013 there were no option position risk requirements under standard market risk rules. At 31 December 2012, the commodity position risk requirement included option risk requirements of £2m.

### Internal assessment of capital adequacy

The group assesses the adequacy of its capital by considering the resources necessary to cover unexpected losses arising from discretionary risks, being those which it chooses to accept (such as credit risk and market risk), and from non-discretionary risks, being those which arise by virtue of its operations (such as operational risk and business risk). The group's capital management and allocation policy is underpinned by its capital management framework. The capital management framework and related policies define the Internal Capital Adequacy Assessment Process by which the Board of Directors of HSBC Bank plc ('the Board') and senior management examine the risk profile from both regulatory and economic capital viewpoints to ensure that the group's level of capital:

- remains sufficient to support the group's risk profile and outstanding commitments;
- exceeds the group's formal minimum regulatory capital requirements by an agreed margin;
- is capable of withstanding a severe economic downturn stress scenario; and
- remains consistent with the group's strategic and operational goals, and shareholder and rating agency expectations.

The regulatory and economic capital assessments rely upon the use of models that are integrated into the group's management of risk.

Economic capital is the internally calculated capital requirement which the group deems necessary to support

the risks to which it is exposed. Regulatory capital is the minimum level of capital which the group is required to hold in accordance with the rules set by the PRA (in the case of the bank and the consolidated group) and by local regulators (for individual subsidiary companies).

The economic capital assessment is the more risk-sensitive measure as it covers a wider range of risks and takes account of the substantial diversification of risk accruing from the group's operations. The group's economic capital models, based on those developed by HSBC, are calibrated to quantify the level of capital that is sufficient to absorb potential losses over a one-year time horizon to a 99.95 per cent level of confidence for its banking activities and to a 99.5 per cent level of confidence for its insurance activities and pension risks. The group's approach to capital management is aligned to its corporate structure, business model and strategic direction.

The group's discipline around capital allocation is maintained within established processes and benchmarks, in particular the approved annual group capital plan.

Regulatory and, increasingly, economic capital are the metrics by which risk is measured and linked to capital within the group's risk appetite framework. The framework expresses the types and quantum of risks to which the group wishes to be exposed. It is approved and monitored by the Board and senior management.

The group identifies and manages risk through a defined risk management framework and continuous monitoring of the risk environment. It assesses and manages certain of these risks via the capital planning

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

process. Risks assessed via capital and those that are not are compared below.

### Risks assessed via capital

#### Credit (including counterparty credit), market and operational risk

The group assesses economic capital requirements for these risk types utilising the embedded operational infrastructure used for the calculation of regulatory capital requirements, together with an additional suite of models that take into account, in particular:

- the increased level of confidence required to meet the group's strategic goals (99.95 per cent); and
- internal assessments of diversification or concentration of risks within the group's portfolios.

When assessing the total requirement post diversification, the group's economic capital assessment typically demonstrates a lower overall capital requirement than the regulatory equivalent, as a result of diversification benefits within and between risk types. However, the group maintains a prudent stance on capital coverage, ensuring that any model risk is mitigated.

#### Interest rate risk in the banking book

Interest rate risk in the banking book ('IRRBB') is defined as the exposure of our non-trading products to interest rates.

This risk arises in such portfolios principally from mismatches between the future yield on assets and their funding costs, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts. IRRBB economic capital is measured as the amount of capital necessary to cover an unexpected loss in the value of our non-trading products over one year to a 99.95% level of confidence. The group's management of this risk is also described on page 64 of the HSBC Bank plc 2013 Accounts.

#### Insurance risk

The group operates a bancassurance model which provides insurance products for customers with whom the group has a banking relationship. Many of these insurance products are manufactured by group subsidiaries but, where the group considers it operationally more effective, third parties are engaged to manufacture and provide insurance products which the group sells through its banking network. When manufacturing products, the group underwrites the insurance risk and retains the risks and rewards associated

with writing insurance contracts. In appropriate circumstances, the group will reduce the amount of insurance risk retained via use of reinsurance contracts. The group works with a limited number of market-leading partners and reinsurers respectively to provide or reinsure these products. The group's risk management of insurance operations is described in more detail on pages 68-71 of the HSBC Bank plc 2013 Accounts.

Economic capital methodologies are in use at the group's two principal life insurance subsidiaries and we continue to make progress towards implementing similar measures for the group's remaining insurance businesses.

#### Pension risk

The group's management of pension risk is also described on pages 75-76 of the HSBC Bank plc 2013 Accounts.

We operate a number of pension plans throughout the world. Some of them are defined benefit plans. Sponsoring Group companies (and in some instances, employees) make regular contributions in accordance with advice from actuaries and in consultation with the plans' trustees (where relevant). In situations where a funding deficit emerges, sponsoring Group companies agree to make additional contributions to the plans, to address the deficit over an appropriate repayment period.

The defined benefit plans invest these contributions in a range of investments designed to meet their long-term liabilities.

Pension risk principally arises from the potential for a deficit in a defined benefit plan from a number of factors, including:

- investments delivering a return below that required to provide the projected plan benefits. This could arise, for example, when there is a fall in the market value of equities, or when increases in long-term interest rates cause a fall in the value of fixed income securities held;
- the prevailing economic environment leading to corporate failures, thus triggering write-downs in asset values (both equity and debt);
- a change in either interest rates or inflation expectations causing an increase in the value of the plan liabilities; and
- plan members living longer than expected (known as longevity risk).

Pension risk is assessed by way of an economic capital model that takes into account potential variations in these factors, using a VAR methodology.

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

### Risks not explicitly assessed via capital

#### Liquidity risk

Liquidity and funding risk management is described in detail on pages 53-60 of the HSBC Bank plc 2013 *Accounts*.

The group uses cash-flow stress testing as part of its control processes to assess liquidity risk. The group does not manage liquidity 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 group recognises that a strong capital base can help to mitigate liquidity risk both by providing a capital buffer to allow an entity to raise funds and deploy them in liquid positions and by serving to reduce the credit risk taken by providers of funds to the group.

#### Structural foreign exchange risk

Structural foreign exchange risk is described in detail on page 65 of the HSBC Bank plc 2013 *Accounts*.

Structural foreign exchange risks arise from our net investments in subsidiaries, branches and associates, the functional currencies of which are other than the British Pound. Unrealised gains or losses due to revaluations of structural foreign exchange exposures are reflected in reserves, whereas other unrealised gains or losses arising from revaluations of foreign exchange positions are reflected in the income statement.

The group's structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that the group's consolidated capital ratios and the capital ratios of the individual banking subsidiaries are largely protected from the effect of changes in exchange rates. This is usually achieved by ensuring that, for each subsidiary bank, the ratio of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio of the subsidiary in question. The group evaluates residual structural foreign exchange exposures using a VAR model, but typically does not assign any economic capital for these, since they are managed within appropriate economic capital buffers.

#### Residual risk

Residual risk is primarily the risk that mitigation techniques prove less effective than expected. This category also includes risks that arise from specific reputational or business events that give rise to exposures not deemed to be included in the major risk categories. The group conducts economic capital assessments of such risks on a regular, forward-looking basis to ensure that their impact is adequately covered by its capital base.

#### Reputational risk

Details of the group's management of reputational risk can be found on page 76 of the HSBC Bank plc 2013 *Accounts*.

As a banking group, the group's reputation depends upon the way in which it conducts its business, but it can also be affected by the way in which clients to whom it provides financial services conduct themselves. The group's reputation is paramount and safeguarding it is the responsibility of all members of staff, supported by a global risk management structure, underpinned by relevant policies and practices, readily available guidance and regular training.

#### Business risk

The PRA specifies that banks, as part of their internal assessment of capital adequacy process, should review their exposure to business risk.

Business risk is the potential negative impact on profits and capital as a result of the group not meeting its strategic objectives, as set out in the rolling operating plan, owing to unforeseen changes in the business and regulatory environment, exposure to economic cycles and technological changes. The group does not explicitly set aside capital against business risk as a distinct category.

Business risk is managed and mitigated through the business planning and stress testing processes, which ensure that the business model and planned activities are appropriately resourced and capitalised consistent with the commercial, economic and risk environment in which the group operates and that the potential vulnerability to the business plans are identified at an early stage so that mitigating actions can be taken proactively.

#### Scenario analysis and stress testing

Scenario analysis and stress testing are important mechanisms in understanding the sensitivities of the group's business and capital plans to the adverse effects of a range of plausible events of varying severity, some of which are extreme. As well as considering the potential financial impact upon plans, a key output of this tool is the consideration and establishment of management action plans for mitigating such events should they, or similar events, arise.

Regulatory capital supply is regularly assessed against demand under a range of stress scenarios, including projected global and local economic downturns. Qualitative and quantitative techniques are used to estimate the potential impact on the group's capital position under such scenarios. The group also participates, where appropriate, in standard scenario analyses requested by regulatory bodies.

As part of the group's risk appetite process, business and capital plans are supported by forecasts of the risk

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

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parameters that drive the group's capital requirements. The group carries out macro-economic stress tests which consider sensitivities of these drivers under a variety of potential economic forecasts in order to examine the possible capital positions that could arise. In any material economic downturn, proactive and structured intervention by management is both inevitable and necessary. Therefore, the group incorporates the effect of such management actions in determining whether or not it is likely to be able to withstand such an event.

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

### Terms and conditions of capital securities

All capital securities included in the regulatory capital base of the group have been issued in accordance with the rules and guidance in the PRA's General Prudential Sourcebook. For regulatory purposes, the group's capital base is divided into two categories, or tiers, depending on the degree of permanence and loss absorbance exhibited. These are tier 1 and tier 2.

The main features of capital securities issued by the group are described below. The balances disclosed in the tables below are the balance sheet carrying amounts under IFRS from the HSBC Bank plc 2013 Accounts and are not the amounts that the instruments contribute to regulatory capital. The regulatory treatment of these instruments and the accounting treatment under IFRS differ, for example, in the treatment of issuance costs or regulatory amortisation. Therefore, the balances disclosed will not reconcile to other amounts disclosed in this document.

#### Tier 1 capital

Tier 1 capital is comprised of shareholders' equity and related non-controlling interests and qualifying capital instruments such as preference shares and hybrid capital securities, after the deduction of certain regulatory adjustments.

#### Ordinary shares

	At 31 December	
	2013	2012
<b>Called up ordinary share capital</b>	<b>£m</b>	<b>£m</b>
HSBC Bank plc ordinary shares (of nominal value £1 each) .....	797	797

Further details of the group's called up share capital can be found in *Note 37 – Called up share capital and other equity instruments* of the Notes on the Financial Statements on pages 199-200 of the HSBC Bank plc 2013 Accounts.

#### Preference shares and related premium

Preference shares are securities which rank higher than ordinary shares for dividend payments and in the event of a winding-up, but generally carry no voting rights. To qualify as capital for regulatory purposes these instruments must have no stated maturity date but may be called and redeemed by the issuer, subject to prior notification to the PRA, and, where relevant, the consent of the local banking regulator. There must also be no obligation to pay a dividend, and (if not paid) the dividend may not cumulate. Dividends on floating rate preference shares are generally related to interbank offered rates. The following table lists the qualifying preference shares in issue at 31 December 2013 together with 31 December 2012 comparatives:

	At 31 December	
	2013	2012
<b>Perpetual shares and related premium</b>	<b>£m</b>	<b>£m</b>
HSBC Bank plc non-cumulative third dollar preference shares .....	431	431
Non-controlling interests in preference shares issued by a subsidiary of the bank .....	150	150
	<b>581</b>	<b>581</b>

Further details of the HSBC Bank plc non-cumulative third dollar preference share capital can be found in *Note 37 – Called up share capital and other equity instruments* of the Notes on the Financial Statements on pages 199-200 of the HSBC Bank plc 2013 Accounts.

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

### Hybrid capital securities

Hybrid capital securities are deeply subordinated securities with some equity features that can be included as tier 1 capital. Hybrid capital securities are issues of securities for which there is no obligation to pay a coupon and if not paid, the coupon is not cumulative. Such securities do not generally carry voting rights and rank higher than ordinary shares for coupon payments and in the event of a winding-up. The securities may be called and redeemed by the issuer, subject to prior notification to the PRA, and, where relevant, the consent of the local banking regulator. If not redeemed, coupons payable may step-up and become floating rate related to interbank offered rates. The following table lists the qualifying hybrid capital securities in issue at 31 December 2013 together with 31 December 2012 comparatives:

		<u>At 31 December</u>	
		<u>2013</u>	2012
		£m	£m
<b>Hybrid Capital Securities</b>			
€900m	7.75% Non-cumulative Subordinated Notes 2040 .....	750	734
£700m	5.844% Non-cumulative Step-up Perpetual Preferred Securities .....	700	700
£300m	5.862% Non-cumulative Step-up Perpetual Preferred Securities .....	323	297
		<u>1,773</u>	<u>1,731</u>

Further details of the terms of these instruments can be found in *Note 30 – Subordinated Liabilities* of the Notes on the Financial Statements on page 178 of the HSBC Bank plc 2013 Accounts.

### Tier 2 capital

Tier 2 capital comprises qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances, unrealised gains arising on the fair valuation of equity instruments held as available-for-sale and reserves arising from the revaluation of properties. Tier 2 capital is divided into two tiers: upper and lower tier 2.

#### Upper tier 2 capital

Upper tier 2 securities are subordinated loan capital that do not have a stated maturity date but may be called and redeemed by the issuer, subject to prior notification to the PRA, and, where relevant, the consent of the local banking regulator. Interest coupons on the floating rate upper tier 2 securities are generally related to interbank offered rates. Upper tier 2 capital may also include, for regulatory purposes, some preference share securities not meeting the full GENPRU requirements for inclusion in the tier 1 capital base. The following table lists the qualifying upper tier 2 securities in issue at 31 December 2013 together with 31 December 2012 comparatives:

		<u>At 31 December</u>	
		<u>2013</u>	2012
		£m	£m
<b>Undated subordinated loan capital and other upper tier 2 instruments</b>			
US\$2,862m	Floating Rate Perpetual Subordinated Debt .....	1,732	1,772
US\$750m	Undated Floating Rate Primary Capital Notes .....	454	464
US\$500m	Undated Floating Rate Primary Capital Notes .....	302	309
US\$300m	Undated Floating Rate Primary Capital Notes (Series 3) .....	181	186
	Other undated subordinated loan capital .....	13	13
		<u>2,682</u>	<u>2,744</u>

Further details of the group's undated subordinated loan capital instruments can be found in *Note 30 – Subordinated liabilities* of the Notes on the Financial Statements on pages 178 of the HSBC Bank plc 2013 Accounts.

## Capital and Risk Management Pillar 3 Disclosures at 31 December 2013

### Lower tier 2 capital

Lower tier 2 capital comprises dated subordinated loan capital repayable at par on maturity which has an original maturity of at least five years. Some subordinated loan capital may be called and redeemed by the issuer, subject to prior notification to the PRA, and, where relevant, the consent of the local banking regulator. If not redeemed, interest coupons payable may step-up or become floating rate related to interbank offered rates. Lower tier 2 capital may also include, for regulatory purposes, some preference share or undated capital securities not meeting the full GENPRU requirements for inclusion in the capital base as either tier 1 or upper tier 2 capital. For regulatory purposes, it is a requirement that lower tier 2 securities be amortised on a straight-line basis in their final five years to maturity thus reducing the amount of capital that is recognised for regulatory purposes. The following table lists the qualifying lower tier 2 securities in issue at 31 December 2013 together with 31 December 2012 comparatives:

		<b>At 31 December</b>	
		<b>2013</b>	2012
		<b>£m</b>	£m
<b>Term subordinated loan capital and other lower tier 2 instruments</b>			
US\$1,450m	Floating Rate Subordinated Loan 2021 .....	<b>877</b>	897
€1,000m	Floating Rate Subordinated Loan 2017 .....	<b>833</b>	816
US\$1,000m	Floating Rate Subordinated Loan 2020 .....	<b>605</b>	619
£600m	4.75% Subordinated Notes 2046 .....	<b>593</b>	593
US\$977m	Floating Rate Subordinated Loan 2040 .....	<b>591</b>	605
€650m	Floating Rate Subordinated Loan 2023 .....	<b>542</b>	-
£500m	5.375% Subordinated Notes 2033 .....	<b>535</b>	572
£500m	4.75% Callable Subordinated Notes 2020 .....	<b>524</b>	522
€500m	Callable Subordinated Floating Rate Notes 2020 .....	<b>396</b>	375
£390m	6.9% Subordinated Loan 2033 .....	<b>390</b>	390
£350m	5% Callable Subordinated Notes 2023 .....	<b>384</b>	390
£350m	5.375% Callable Subordinated Step-up Notes 2030 .....	<b>364</b>	390
£350m	Floating Rate Subordinated Loan 2022 .....	<b>350</b>	350
£300m	6.5% Subordinated Notes 2023 .....	<b>299</b>	299
US\$450m	Subordinated Floating Rate Notes 2021 .....	<b>272</b>	278
US\$300m	7.65% Subordinated Notes 2025 .....	<b>230</b>	244
£225m	6.25% Subordinated Notes 2041 .....	<b>224</b>	224
€250m	Floating Rate Subordinated Loan 2021 .....	<b>208</b>	204
	Other term subordinated loan capital instruments less than £100m .....	<b>539</b>	561
		<b>8,756</b>	8,329

Further details of the terms of these instruments can be found in *Note 30 – Subordinated liabilities* of the Notes on the Financial Statements on page 178 of the HSBC Bank plc 2013 Accounts. The table in *Note 30 – Subordinated liabilities* includes a number of dated subordinated loans which do not qualify as Lower Tier 2 – these total £342m at 31 December 2013 (and £350m at 31 December 2012).



## Glossary

<b>Terms</b>	<b>Definition</b>
<b>Available-for-sale financial assets</b>	Those non-derivative financial assets that are in terms of IFRS not classified as a) loans and receivables b) held-to-maturity investments or c) financial assets at fair value through profit or loss.
<b>Basel II</b>	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.
<b>Basel 2.5</b>	The enhancements to the existing Basel II framework announced by the Basel Committee in April 2008 as an immediate response to the financial crisis. These enhancements mostly affect the definition of capital as well as the risk-weighting rules for credit, market risk and concentration risk.
<b>Basel III</b>	In December 2010, the Basel Committee issued final rules 'Basel III: A global regulatory framework for more resilient banks and banking systems' and 'Basel III: International framework for liquidity risk measurement, standards and monitoring'. Together these documents present the Basel Committee's reforms to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. In June 2011, the Basel Committee issued a revision to the former document setting out the finalised capital treatment for counterparty credit risk in bilateral trades. The Basel III requirements will be phased in starting 1 January 2013 with full implementation by 1 January 2019.
<b>Capital conservation buffer</b>	A capital buffer, prescribed by regulators under Basel III, and designed to ensure banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred. Should a bank's capital levels fall within the capital conservation buffer range, capital distributions will be constrained by the regulators.
<b>Capital Requirements Directive ('CRD')</b>	The European Union's capital adequacy rules (in directives 2006/48 and 2006/49) enacting the Basel II framework issued by the Basel Committee in June 2006.
<b>CRD III</b>	The enabling instrument by which the European Union has enacted the Basel 2.5 enhancements.
<b>CRD IV</b>	The European Commission's proposals for a new Regulation and Directive, published in July 2011, to give effect to the Basel III framework in the EU.
<b>Common equity tier 1 capital and Common equity</b>	The highest quality form of regulatory capital under Basel III. It comprises common shares issued and related share premium, retained earnings and other reserves excluding the cashflow hedging reserve, less specified regulatory adjustments.
<b>Core tier 1 capital</b>	The highest quality form of regulatory capital. It comprises total shareholders' equity and related non-controlling interests, less goodwill and intangible assets, and certain other regulatory adjustments.
<b>Countercyclical capital buffer ('CCB')</b>	A capital buffer, prescribed by regulators under Basel III, which aims to ensure capital requirements take account of the macro-economic environment in which banks operate. The buffer will provide additional capital to protect the banking sector against the increased potential for future losses which arises when excess credit growth in the financial system as a whole is associated with an increase in system-wide risk.
<b>Derivatives</b>	Financial instruments whose value is based on the performance of one or more underlying assets, for example bonds or currencies.
<b>ECAI</b>	External Credit Assessment Institution, such as Moody's Investors Service, Standard & Poor's Ratings Group or Fitch Group.

## Glossary

<b>Terms</b>	<b>Definition</b>
<b>Economic capital</b>	The internally calculated capital requirement which is deemed necessary by the group to support the risks to which it is exposed at defined confidence levels.
<b>Equity IRB simple risk weight approach</b>	The simplest of 3 approaches prescribed for calculating risk-weighted assets and expected loss on equity exposures under the IRB approach.
<b>Expected loss ('EL') (regulatory)</b>	A regulatory measure of the amount expected to be lost on an exposure using a 12 month time horizon and downturn loss estimates. EL is calculated by multiplying the Probability of Default (a percentage) by the Exposure at Default (an amount) and Loss Given Default (a percentage).
<b>Exposure</b>	A claim, contingent claim or position which carries a risk of financial loss.
<b>Exposure at default ('EAD') and Exposure value</b>	The amount expected to be outstanding after any credit risk mitigation, if and when a counterparty defaults. EAD reflects drawn balances as well as allowance for undrawn commitments and contingent exposures, and is usually measured over a 12 month horizon.
<b>Fair value</b>	Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
<b>FSA</b>	The Financial Services Authority of the United Kingdom.
<b>GENPRU</b>	The PRA's rules, as set out in the General Prudential Sourcebook.
<b>Held-to-maturity</b>	An accounting classification for investments acquired with the intention of being held until they mature.
<b>Incremental risk charge</b>	A measure of the direct and indirect losses that could occur on positions in the Trading Book as a result of the default of an issuer, or a change in its creditworthiness.
<b>Institutions</b>	Under the Standardised approach, Institutions are classified as credit institutions or investment firms. Under the IRB approach, Institutions also include regional governments and local authorities, public sector entities and multilateral development banks.
<b>Insurance risk</b>	A risk, other than financial risk, transferred from the holder of a contract to the insurance provider. The principal insurance risk is that, over time, the combined cost of claims, administration and acquisition of the contract may exceed the aggregate amount of premiums received and investment income.
<b>Internal Capital Adequacy Assessment Process</b>	The group's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
<b>Internal ratings-based approach ('IRB')</b>	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
<b>IRB advanced approach</b>	The IRB advanced approach is a method of calculating credit risk capital requirements using internal PD, LGD and EAD models.
<b>IRB foundation approach</b>	The IRB foundation approach is a method of calculating credit risk capital requirements using internal PD models but supervisory estimates of LGD and conversion factors for the calculation of EAD.
<b>Leverage ratio</b>	A measure, prescribed by regulators under Basel III, which is the ratio of tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives, and should generally follow the accounting measure of exposure. This supplementary measure to the risk based capital requirements is intended to constrain the build-up of excess leverage in the banking sector.

## Glossary

<b>Terms</b>	<b>Definition</b>
<b>Liquidity risk</b>	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 an excessive cost. This risk arises from mismatches in the timing of cash flows.
<b>Loss given default ('LGD')</b>	The estimated ratio (percentage) of the economic loss on an exposure to the amount outstanding at default (EAD) upon default of a counterparty.
<b>Probability of default ('PD')</b>	The probability that an obligor will default within a one-year time horizon.
<b>Prudential Regulatory Authority ('PRA')</b>	The Prudential Regulation Authority of the United Kingdom
<b>Qualifying revolving retail exposures</b>	Retail IRB exposures not exceeding €100k that are revolving, unsecured, and (to the extent they are not drawn) immediately and unconditionally cancellable, such as credit cards.
<b>Regulatory capital</b>	The capital which the bank holds, determined in accordance with rules established by the PRA (in the case of the bank and the consolidated group) and by local regulators (for individual group companies).
<b>Resecuritisation</b>	A securitisation transaction where one or more of the underlying exposures is itself a securitisation exposure.
<b>Retail IRB</b>	Retail exposures that are treated under the IRB approach.
<b>Risk appetite</b>	An assessment of the types and quantum of risks to which the group wishes to be exposed.
<b>Risk-weighted assets ('RWA')</b>	Calculated by assigning a degree of risk expressed as a percentage (risk weight) to an exposure in accordance with the applicable rules.
<b>Securitisation</b>	<p>In general, a transaction or scheme whereby the credit risk associated with an underlying exposure, or pool of exposures, is tranching and where payments to investors in the transaction or scheme are dependent upon the performance of the underlying exposure or pool of exposures.</p> <p>A traditional securitisation involves the transfer of the exposures being securitised to an SPE which issues securities. In a synthetic securitisation, the tranching is achieved by the use of credit derivatives and the exposures are not removed from the balance sheet of the originator.</p> <p>As a specific, defined regulatory term a securitisation differs from a resecuritisation in that none of the underlying exposure or exposures is itself a securitisation.</p>
<b>Special Purpose Entity ('SPE')</b>	A corporation, trust or other non-bank entity, established for a narrowly defined purpose, including for carrying on securitisation activities. The structure of the entity and activities are intended to isolate the obligations of the SPE from those of the originator and the holders of the beneficial interests in the securitisation.
<b>Standardised approach</b>	<p>In relation to credit risk, a method for calculating credit risk capital requirements using ECAI ratings and supervisory risk weights.</p> <p>In relation to operational risk, a method of calculating the operational capital requirement by the application of defined percentage charges to the three year average gross income of eight specified business lines.</p>
<b>Standard market risk PRR rules</b>	The PRA's rules regarding the calculation of market risk capital requirements for trading book exposures which are not subject to VAR model permissions. The rules divide risks into a number of standard types, within which risk is measured by the application of defined percentage charges to both net & gross exposures.

## Glossary

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<b>Terms</b>	<b>Definition</b>
<b>Stressed VAR</b>	A measure of VAR using a specific, continuous, one-year period of stress for the trading portfolio.
<b>Tier 1 capital</b>	A component of regulatory capital, comprising core tier 1 capital and other tier 1 capital. Other Tier 1 capital includes qualifying hybrid capital instruments such as non-cumulative perpetual preference shares and innovative Tier 1 securities.
<b>Tier 2 capital</b>	A component of regulatory capital comprising qualifying subordinated loan capital, related non-controlling interests and allowable collective impairment allowances. Tier 2 capital also includes reserves arising from unrealised gains on the fair valuation of equity instruments held as available-for-sale and on the revaluation of properties.
<b>Value at risk ('VAR')</b>	<p>In general, a technique that measures the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.</p> <p>As a specific, defined regulatory term VAR differs from Stressed VAR as follows:</p> <ul style="list-style-type: none"> <li>• VAR is calculated using the changes in relevant market factors observed during the specified time horizon; whereas,</li> <li>• Stressed VAR replaces these with movements from a specific, continuous one-year period of stress for the trading portfolio.</li> </ul>

