Funding, Liquidity and Capital Management
The new Regulatory Landscape

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HSBC’s approach to Funding, Liquidity and Capital Management

- Strong capital position with Core Tier 1 ratio > 10.5%
- Conservative liquidity management and limited dependence on wholesale markets with AD ratio < 80%
- Legal entities and geographies required to be self-sufficient for funding and to be able to “stand alone” in case of liquidity stress
- Common Group framework and risk appetite, shaped by our long history of operating in 85 countries
- But not a one-size fits all: tailored to markets in which entities operate
Diversity of Funding Models - Banks

Source: IMF, Nov 2010 - Impact of Regulatory Reforms on Large and Complex Financial Institutions
## Advances to Core Funding Ratio - HSBC

### Advances

*Core deposits & term debt with remaining maturity > 1 year*

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
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</thead>
<tbody>
<tr>
<td>HSBC Bank plc</td>
<td>105.0</td>
<td>103.0</td>
<td>99.7</td>
</tr>
<tr>
<td>The Hongkong and Shanghai Banking Corporation</td>
<td>70.3</td>
<td>78.9</td>
<td>55.5</td>
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<tr>
<td>HSBC Bank USA</td>
<td>101.0</td>
<td>98.3</td>
<td>81.4</td>
</tr>
<tr>
<td>Other Entities</td>
<td>85.9</td>
<td>89.1</td>
<td>89.2</td>
</tr>
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Source: Annual Report and Accounts, HSBC Holdings plc
We are reaching the conclusion of a period of dramatic regulatory reform

2007
- Government injections of liquidity
- Initial interest rate cuts

2008
- Further liquidity injections
- Creation of Bail-out schemes (TARP, APS)
- Interest rates cut further
- Impetus from G20
- Development of local regulatory responses

2009
- Initial regulatory reforms to trading books
- Focus on remuneration
- Interest rates cut to near zero
- Economic stimulus packages

2010
- Basel rules on capital, liquidity and funding
- Dodd-Frank Act in US
- Independent Commission on Banking in UK
- Recovery & Resolution Plans

2011
- Translation of Basel rules to CRD4
- Observation period for liquidity framework
- FSB proposals on SIFIs
- Implementation of Dodd-Frank
- ICB conclusions
- Development of EU Crisis Management Frameworks
Liquidity (Basel 3 / CRD4)

- Very supportive of strengthening liquidity standards
- Funding and Liquidity as important for banks as capital
- Supportive of observation period for LCR in CRD4 to inform
  - A broader definition of liquid assets
  - Clearer guidance on the definition of “operational” deposits
  - Reduced outflow factors in areas such as: SME deposits > Eur1m; committed liquidity facilities
- Solo vs Consolidated reporting
- Intragroup Funding (Large exposures / R&R)
- Disclosure
Supportive of a more globally consistent capital framework, higher quality capital

Define the linkages between various capital buffers

Pro-cyclicality of CVA

Trade Finance

CoCos
Modigliani–Miller: does it work for banks?

Exhibit 18: Implied COE from current price/tangible books versus Tier 1 levels (Core Tier 1 for developed market banks)

* COEs based on 2012e, implied long-term growth of 3% for developed markets, 5% for Asia, LatAm, CEEMEA

Source: HSBC research
Which instruments should be bailed in?

- FSB principles:
  (i) Any debt write-down outside of an insolvency procedure must respect the creditor hierarchy; and
  (ii) No creditor should be worse off in resolution than they would have been in liquidation.
- Write down or conversion
- Triggers
- Investor base
- Impact for deposit-funded institutions
- ICB
Challenges in conducting reform

**Challenge 1: Rebuilding a regulatory framework after the worst financial crisis of the 1930’s where the origins had multiple causes:**

- Poor management
- Poor governance
- Poor supervision
- Public policy goals re housing that had unintended consequences
- Excessive liquidity coupled with low risk free bond rates
- Excessive reliance on modelling versus judgment
- Overreliance on and misunderstanding of ratings

**Challenge 2: Create a level playing field so far as possible across countries:**

- With different shaped financial systems
- At different stages of economic development
- With differing degrees of central bank/supervisory intervention
- With different growth prospects
Challenges in conducting reform

<table>
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<tr>
<th>Challenge 3: In building a new system:</th>
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<tbody>
<tr>
<td>• Build a new framework that limits the risk of repetition of a crisis but at the same time doesn’t excessively hamper economic activity</td>
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<td>• Build a system that constrains over exuberant credit supply but doesn’t choke credit formation to the real economy</td>
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<tr>
<td>• Build a system that promotes good innovation but doesn’t allow arbitrage and misaligned structures</td>
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<td>• Create a system with the right incentives</td>
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<th>Challenge 4: And if it all goes wrong:</th>
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<td>• Find a way to mitigate the impact</td>
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<td>• That deals with cross border claims</td>
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<td>• That avoids contagion</td>
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<tr>
<td>• That recognises that every country is starting from a different place in terms of legal architecture to deal with this</td>
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Inputs to a new regulatory system

- Macro prudential input / Financial stability measures
- Business model / Permitted activities / Funding structure / Administrative measures
- Recovery / Resolution frameworks
- Settlement architecture / Central counterparties
- Intrusive supervision
- Liquidity
- Capital
- SIFI
Conclusions

- Find the right balance between hard-coded rules and macro-prudential policies
- Consistency / level playing field
- Extraterritoriality
- Business model: branch or subsidiary structure
- Role and size of banking system within financial system
- Impact assessment / Observation periods
Thank you