

Financial Institutions Ratings

HSBC Holdings PLC – AT1 rating report



Security ratings

Outlook	Stable
5.625% USD 1.5bn perpetual subordinated contingent convertible securities	BBB
6.375% USD 2.25bn perpetual subordinated contingent convertible securities	BBB
5.25% EUR 1.5bn perpetual subordinated contingent convertible securities	BBB
6.375% USD 2.45bn perpetual subordinated contingent convertible securities	BBB
6% EUR 1bn perpetual subordinated contingent convertible securities	BBB
6.875% USD 2bn perpetual subordinated contingent convertible securities	BBB
6% USD 3bn perpetual subordinated contingent convertible securities	BBB
4.7% SGD 1bn perpetual subordinated contingent convertible securities	BBB
4.75% EUR 1.25bn perpetual subordinated contingent convertible securities	BBB
6.25% USD 2.25bn perpetual subordinated contingent convertible securities	BBB
6.5% USD 1.75bn perpetual subordinated contingent convertible securities	BBB

The ratings have not been solicited by the issuer; the analysis is based solely on public information

Rating rationale

Scope rates at BBB, Stable the above referenced issues of perpetual subordinated contingent convertible securities issued by HSBC Holdings PLC. The ratings are based on the following considerations:

- Senior unsecured debt rating (MREL/TLAC eligible): AA-, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating. The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks. Please refer to Scope's Bank Capital Instruments Rating Methodology published in May 2018 for more details.

The additional notch for these securities reflects the relatively demanding stance of the UK regulator; e.g. requesting 7% CET1 fully loaded triggers on AT1 securities, the presumed conversion of AT1 securities when CET1 triggers are breached (as illustrated in bank stress test scenarios), and comparatively high Pillar 2 requirements.

The release of this rating report does not constitute a rating action. Last rating action was assigned on 15 June 2017. For further information on the last rating action and regulatory information please click [here](#).

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Issuer credit profile

The Issuer Rating of AA for HSBC Holdings is based on the group's very diverse and unique business franchise as well as management's conservative risk appetite. While not immune to challenging market conditions, these characteristics enable HSBC to generate solid earnings across credit cycles. As well, the group maintains consistently reassuring liquidity, funding and capital positions.

In June 2018, management presented a strategy update with the theme being "Return to Growth and Value Creation". We note positively the continuity in the strategy, with the group focusing on strengths in Asia, the UK and its international network. Further, management assured that higher returns will not come from a change in the group's risk appetite. Investments of USD 15-17bn are planned, with a significant portion to be used for enhancing the customer experience, technology, regulatory programs and cyber security. By 2020, the group targets a ROTC above 11% and during 2018-2020, expects to maintain a CET1 ratio above 14%.

The ratings also recognize that the group's size and complexity mean that HSBC is more vulnerable to operational, governance, and internal control risks. With its broad-based focus on emerging markets and the ambition to facilitate international trade and capital flows, HSBC is also more exposed to the potential volatility inherent in these markets and to growing protectionist policies that may reduce global and regional trade flows.

Summary terms

Issuer	HSBC Holdings plc
Issue Date	17 September 2014
Amount	USD 1.5bn
Coupon	<ul style="list-style-type: none"> • 5.625% fixed until first call date, reset every 5 years thereafter • From first call date at mid-swap rate + 3.625% • Payable in arrear semi-annually
Format	Perpetual subordinated contingent convertible securities, callable January 2020 and every five years thereafter
Conversion rate	USD 4.35578 per ordinary share
ISIN	US404280AR04

Issue Date	17 September 2014
Amount	USD 2.25bn
Coupon	<ul style="list-style-type: none"> • 6.375% fixed until first call date, reset every 5 years thereafter • From first call date at mid-swap rate + 3.705% • Payable in arrear semi-annually
Format	Perpetual subordinated contingent convertible securities, callable September 2024 and every five years thereafter
Conversion rate	USD 4.33578 per ordinary share
ISIN	US404280AS86



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Issue Date	17 September 2014
Amount	EUR 1.5bn
Coupon	<ul style="list-style-type: none">• 5.25% fixed until first call date, reset every 5 years thereafter• From first call date at mid-swap rate + 4.383%• Payable in arrear semi-annually
Format	Perpetual subordinated contingent convertible securities, callable September 2022 and every five years thereafter
Conversion rate	EUR 3.37514 per ordinary share
ISIN	XS1111123987

Issue Date	30 March 2015
Amount	USD 2.45bn
Coupon	<ul style="list-style-type: none">• 6.375% fixed until first call date, reset every 5 years thereafter• From first call date at mid-swap rate + 4.3675%• Payable in arrear semi-annually
Format	Perpetual subordinated contingent convertible securities, callable March 2025 and every five years thereafter
Conversion rate	USD 4.03488 per ordinary share
ISIN	US404280AT69

Issue Date	29 September 2015
Amount	EUR 1bn
Coupon	<ul style="list-style-type: none">• 6% fixed until first call date, reset every 5 years thereafter• From first call date at 5-year EUR mid-swap + 5.338%• Payable in arrear semi-annually
Format	Perpetual subordinated contingent convertible securities, callable September 2023 and every five years thereafter
Conversion rate	EUR 3.73559 per ordinary share
ISIN	XS1298431104

Issue Date	1 June 2016
Amount	USD 2bn
Coupon	<ul style="list-style-type: none">• 6.875% fixed until first call date, reset every 5 years thereafter• From first call date at 5-year USD mid-swap rate + 5.514%• Payable in arrear semi-annually
Format	Perpetual subordinated contingent convertible securities, callable June 2021 and every five years thereafter
Conversion rate	USD 3.9474 per ordinary share
ISIN	US404280BC26



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Issue Date	22 May 2017
Amount	USD 3bn
Coupon	<ul style="list-style-type: none">• 6% fixed until first call date, reset every 5 years thereafter• From first call date at 5-year USD mid-swap rate + 3.746%• Payable in arrear semi-annually
Format	Perpetual subordinated contingent convertible securities, callable May 2027 and every five years thereafter
Conversion rate	USD 3.4799 per ordinary share
ISIN	US404280BL25

Issue Date	8 June 2017
Amount	SGD 1bn
Coupon	<ul style="list-style-type: none">• 4.7% fixed until first call date, reset every 5 years thereafter• From first call date at 5-year SGD swap rate + 2.87%• Payable in arrear semi-annually
Format	Perpetual subordinated contingent convertible securities, callable June 2022 and every five years thereafter
Conversion rate	SGD 4.80694 per ordinary share
ISIN	XS1624509300

Issue Date	4 July 2017
Amount	EUR 1.25bn
Coupon	<ul style="list-style-type: none">• 4.75% fixed until first call date, reset every 5 years thereafter• From first call date at 5-year EUR mid-swap rate + 3.844%• Payable in arrear semi-annually
Format	Perpetual subordinated contingent convertible securities, callable July 2029 and every five years thereafter
Conversion rate	EUR 3.05451 per ordinary share
ISIN	XS1640903701

Issue Date	18 March 2018
Amount	USD 2.25bn
Coupon	<ul style="list-style-type: none">• 6.25% fixed until first call date, reset every 5 years thereafter• From first call date at 5-year USD mid-swap rate + 3.453%• Payable in arrear semi-annually
Format	Perpetual subordinated contingent convertible securities, callable March 2023 and every five years thereafter
Conversion rate	USD 3.7881 per ordinary share
ISIN	US404280BN80

Issue Date	18 March 2018
Amount	USD 1.75bn
Coupon	<ul style="list-style-type: none"> • 6.5% fixed until first call date, reset every 5 years thereafter • From first call date at 5-year USD mid-swap rate + 3.606% • Payable in arrear semi-annually
Format	Perpetual subordinated contingent convertible securities, callable March 2028 and every five years thereafter
Conversion rate	USD 3.7881 per ordinary share
ISIN	US404280BP39

Main Risks	
Coupon Cancellation	<ul style="list-style-type: none"> • Fully discretionary • Mandatory if there are insufficient distributable items to pay coupons on these securities, parity securities and any junior securities; or coupons on these securities plus other distributions referred to in Article 141(2) of CRD IV exceed the maximum distributable amount; or the solvency condition is not satisfied in respect of such coupon payment • Upon order of regulator
Principal Loss Absorption	<ul style="list-style-type: none"> • Full and automatic conversion into ordinary shares upon trigger breach at conversion price subject to conversion share offer • Regulatory action, including the exercise of UK bail-in power
Trigger for Principal Loss Absorption	Consolidated group CET1 ratio < 7% on fully loaded basis

Source: Prospectuses, Scope Ratings

Key risks

A. Coupon cancellation

Key risk: Coupon cancellation

Coupon payments are fully discretionary and are subject to distribution restrictions.

Coupon payments are fully discretionary and are subject to distribution restrictions. As well, coupons are mandatorily cancelled if there are insufficient distributable items (based on issuer accounts on an unconsolidated basis) to pay coupons on these securities, parity securities and any junior securities or if the sum of coupons on these securities plus other distributions referred to in Article 141(2) of CRD IV (i.e. dividends and variable compensation) exceed the maximum distributable amount (MDA).

We do not consider distributable items to be a limiting factor for HSBC to make coupon payments. As of end-2017, HSBC Holdings PLC, had USD 38bn in reserves available for distribution.

In addition, the issuer must be solvent immediately after making payments related to the AT1 securities. The issuer is considered solvent if it can pay debts owed to senior creditors as they fall due and if the value of its unconsolidated gross assets is at least equal to the value of its unconsolidated gross liabilities.

Combined buffer requirement (CBR)

Article 141 of CRD IV imposes certain restrictions on discretionary distributions (dividends, variable remuneration and payments on AT1 securities) when the combined buffer requirement (CBR) is not met. The CBR is comprised of the capital conservation buffer, the countercyclical buffer and systemic risk buffers as applicable.

To determine whether the MDA needs to be calculated, a bank should meet both Pillar 1 and Pillar 2 capital requirements as well as the CBR. For UK banks, Pillar 2 capital requirements are referred to as Pillar 2A requirements. At least 56% of the requirement must be met with CET1 capital and no more than 25% with Tier 2 capital. We note that the Pillar 2 requirements of UK banks are often higher than those for ECB-supervised banks, even when comparing only the CET1 component.

By 2019, we estimate that HSBC will need to maintain a CET1 ratio of about 12%, a Tier 1 capital ratio above 14%, and a total capital ratio of 17% to avoid distribution restrictions on its AT1 securities (Table 1). This assumes that the Pillar 2A requirement does not change. As of 1Q 2018, HSBC's Pillar 2A requirement was 3.5%, of which at least 2% should be met with CET1 capital.

Table 1: Estimated capital requirements

	2017	Q1 2018	2019
Required CET1 associated with distribution restrictions:	8.6%	10.6%	11.9%
Combined buffer (CBR)			
- Capital conservation	1.25%	1.88%	2.50%
- Systemic	1.00%	1.50%	2.00%
- Countercyclical	0.20%	0.77%	0.93%
Pillar 2A CET1 requirement	1.60%	2.00%	2.00%
Pillar 1 CET1 requirement	4.50%	4.50%	4.50%
HSBC Holdings PLC CET1, fully loaded (%)	14.5%	14.5%	
Distance to CET1 requirement incl. CBR (%)	5.9%	3.9%	
Distance to CET1 requirement incl. CBR (USD bn)	51.6	34.4	
HSBC Holdings PLC Tier 1, fully loaded (%)	16.4%	17.6% transitional	
Required Tier 1, incl. CBR (%)	10.6%	12.8%	14.1%
Distance to Tier 1 requirement incl. CBR (%)	5.8%	4.8%	
HSBC Holdings PLC total capital, fully loaded (%)	18.3%	20.7% transitional	
Required total capital, incl. CBR (%)	13.3%	15.7%	17.0%
Distance to total capital requirement incl. CBR (%)	4.9%	5.0%	
RWAs (USD bn)	871	894	

Note: Countercyclical buffer is estimated to increase to 0.9% in 2019 based on the assumption that the CCyB rate for Hong Kong will increase to 2.5% and that Hong Kong accounts for about 25% of the group's exposure.
Source: Company data, Scope Ratings

Both the capital conservation and G-SIB buffers are being phased-in until 2019. Scope expects the countercyclical buffer to increase due to the group's exposures in the UK and Hong Kong. The current UK countercyclical buffer (CCyB) rate is 0.5% but will increase to

1% in November 2018. This is in line with the UK authorities' policy to set a UK CCyB rate of around 1% in a "standard risk environment". Meanwhile, the current CCyB rate in Hong Kong is 1.875% but with continuing strong credit growth, Scope expects this to increase to 2.5% in January 2019.

B. Principal loss absorption

Key risk: Principal loss absorption

The mechanism for loss absorption is full conversion into shares.

The securities have one trigger:

- Consolidated group CET1 ratio < 7% on fully loaded basis

Under the terms of the securities, there is full conversion into shares when the trigger level is breached. The trigger level is breached when HSBC's consolidated CET1 ratio is less than 7% on a fully loaded basis. AT1 capital instruments issued by UK banks generally have fully loaded CET1 triggers while non-UK banks have transitional CET1 triggers.

By acquiring the securities, investors "acknowledge, accept, consent and agree to be bound by the exercise of any UK bail-in power". These include the power to write-down and convert capital instruments when an institution is no longer considered viable and the use of the bail-in tool to cancel all or a portion of the principal amount of, or interest on, certain unsecured liabilities of a failing institution and/ or convert certain debt claims into another security, including ordinary shares.

Distance to trigger

As of 31 March 2018, HSBC's fully loaded CET1 ratio was 14.5%, compared to the 7% trigger level in the securities. Scope expects the group's CET1 capital position to remain comfortably above the trigger level.

Table 2: Distance to trigger

	2017	Q1 2018	2019
Trigger level	7.0%	7.0%	7.0%
HSBC Holdings PLC CET1, fully loaded (%)	14.5%	14.5%	
Distance to trigger (%)	7.5%	7.5%	
Distance to trigger (USD bn)	65.2	67.0	

Source: Company data, Scope Ratings



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