

Comparison of HSBC and Standard Chartered ('StanChart') Q3 2023 interim results

StanChart announced:

- a \$697 mil write-down of the value of its shares in China Bohai Bank ('Bohai')
- an increase in its loan loss provision on commercial property lending in China by \$186 mil
- total hit = \$883 mil

HSBC announced, a few days later:

- \$500 mil increase in its loan loss provision on commercial property lending in China
- No alteration to the value of its shares in Hang Seng Bank ('HSB')

The announcements:

- Followed one another in quick succession
- Announced write-downs that were in the same broad range as one another
- Announced write-downs that sounded as if they were for the same reason – Chinese real estate – whereas HSBC's write-down was connected solely with its own commercial property lending, and not to do with the commercial and residential property lending undertaken by the Chinese bank in which it owns a stake
- Were accompanied by emollient explanations:
 - Inevitable and minor bump along the road of China's growth (StanChart)
 - Worst is over in Chinese real estate and normal service will now be resumed (HSBC)

Accounting principles:

- HSBC, owning 62% of Hang Seng Bank, ought to consolidate it but it doesn't: it values it on the equity method
- This method is valid between StanChart and Bohai because the ownership level is 16.26%
- The method is: Shareholders' Equity of the bank in its reporting currency x percentage share owned x exchange rate (against HKD for HSB, and RMB for Bohai)
- As regards valuing loans, a total or partial loan loss results in the value of the loan on the Asset side of the bank's balance sheet being reduced: the bank's Shareholder's Equity is in effect reduced by the same amount, because the reduction in the Asset reduces the profit that would otherwise cause Shareholder's Equity to rise
- Banks need not carry a general loan loss provision as part of 'Liabilities', or as a heading amongst 'Shareholders' Equity' components, or within one of the types of 'Reserves' that are headings within Shareholders' Equity
- Instead the possibility of a loan loss is recognised by the bank allocating a larger share of its Shareholders' Equity behind that loan, which constrains the amount of other business it can do
- The bank calculates an 'Expected Credit Loss' or 'ECL' against a doubtful loan, and it must cover the ECL with equity in full

- When the ECL rises to become 100% of the loan's value, the loss changes from 'Expected' to 'Definite', and the loan is written off against the bank's equity
- It is therefore of prime importance that the ECL be accurate, and not be window-dressing, concealing upcoming loan losses

StanChart and HSBC operate in substantially the same market in China as regards property lending:

- Commercial property lending from their own bank
- Both commercial and residential property lending from the books of the banks in which they own shares
- This is a doubling-up of exposure

Assuming StanChart's write-downs are based on market conditions and metrics – and not on fresh air – then HSBC's write-downs appear very different for a bank subject to identical conditions.

HSBC is four times the size of StanChart:

- Group equity of \$165 bil¹ compared to StanChart's group equity of \$48 bil²
- Commercial property lending in China of \$13.6 bil³ compared to StanChart's \$2.7 bil⁴
- Value of investment stake in HSB of \$14.6 bil compared to StanChart's \$2.5 bil in Bohai

StanChart commercial property lending in China at end of Q3 2023:

- \$2.7 bil of loans⁵
- Reduced by \$0.2 bil from previous quarter by the write-down, as per the accounting principles

Bohai property lending at end of Q2 2023, using RMB/US\$ exchange rate of 7.33:

- Personal residential and small business property lending - \$23.4 bil⁶
- Of which Non-Performing - \$231 mil⁷
- Commercial property lending – \$12.3 bil⁸
- Against collateral of \$8.5 bil⁹
- Of which Non-Performing - \$381 mil¹⁰
- There is no loan loss provision shown as part of 'Liabilities' (p. 72) or as a heading amongst 'Equity' components (p. 73) or in the detail about Reserves (p. 118)

¹ HSBC Q3 investor presentation p. 15

² Q3 2023 Investor presentation p. 29

³ HSBC Q3 investor presentation p. 8

⁴ StanChart Q3 2023 Investor presentation p. 14

⁵ StanChart Q3 2023 Investor presentation p. 14

⁶ Bohai interim report p. 89

⁷ Bohai interim report p. 89

⁸ Bohai interim report p. 90

⁹ Bohai interim report p. 90

¹⁰ Bohai interim report p. 90

Bohai equity:

- \$15.6 bil¹¹
- StanChart share in Bohai – 16.26%¹²
- Value of StanChart’s stake - \$2.5 bil
- Write-down (\$697 mil) as percentage of value of StanChart’s stake – 28%
- StanChart group equity - \$48 bil¹³
- Bohai stake’s value as percentage of StanChart group equity – 5.2%
- Bohai writedown’s value as percentage of StanChart group equity – 1.5%
- But what was the reason for the write-down?
 - The exchange rate has not changed materially
 - Bohai is still profitable

Equivalent data for HSBC:

HSBC group equity \$165 bil¹⁴

Commercial property lending in China at end of Q3 2023:¹⁵

- Total \$13.6 bil, booked in Hong Kong (\$7.5 bil), mainland China (\$5.1 bil) and elsewhere in HSBC group (\$1.0 bil)
- \$2.2 bil is rated as ‘sub-standard’, the fourth category of credit quality out of five
- \$3.5 bil is rated as ‘credit impaired’, the fifth and lowest category
- There is no break-out of these figures, as there is for Hong Kong, as to how much of it unsecured (i.e. the bank has no mortgage security on the piece of commercial property that is being financed, which defies the normal presumption about all property lending)
- \$5.7 bil of loans are in categories four and five, or 42% of the entire book
- The ECL - to which HSBC added \$500 mil in Q3 2023 – now stands at \$2.3 bil, a shortfall of \$3.4 bil compared to the loans in categories four and five, and that is 2% of HSBC Group’s equity
- The ECL is 17% of the loan book (\$2.3 bil/\$13.6 bil)

HSBC’s Hong Kong Commercial property lending book is particularly poor:

- \$4.7 bil out of the \$7.5 bil booked in Hong Kong is either ‘sub-standard’ (\$1.5 bil) or ‘credit-impaired’ (\$3.2 bil), meaning 63% of the Hong Kong loan book into commercial property is of poor quality
- \$1.1 bil out of the \$1.5 bil ‘sub-standard’ is unsecured
- \$2.6 bil of the \$3.2 bil ‘credit impaired’ is unsecured
- This means that 79% of the portion of the Hong Kong loan book into commercial property that is of poor quality is also unsecured
- The ECL in Hong Kong now stands at \$2.0 bil, whilst the amount that is at risk is \$4.7 bil

¹¹ Bohai interim report p. 73

¹² Bohai interim report p. 51

¹³ Q3 2023 Investor presentation p. 29

¹⁴ HSBC Q3 investor presentation p. 15

¹⁵ HSBC Q3 investor presentation p. 8

HSB's lending at the end of 2022, in US\$, converted from HKD at 7.82:

- Residential mortgages - \$40.7 bil and loan loss provision of zero¹⁶
- Commercial property lending - \$30.4 bil and loan loss provision of \$1.1 bil (3.6%)¹⁷
- HSB has a 3.6% loan loss provision in the same business in which HSBC carries a 17% loan loss provision
- That is inadequate if the two banks are operating in the same market

Equity of HSB:

- in HKD – HKD184 bn¹⁸
- in US\$ at 7.82 - \$23.5bn
- HSBC share of HSB – 62%¹⁹
- Value of HSBC's stake in HSB - \$14.6 bil

Interim conclusions for HSBC:

- HSBC's commercial property lending in China has an ECL that is too low by \$1.4 bil at \$2.3 bil:
 - The ECL of secured 'sub-standard' loans should be 40%
 - The ECL of unsecured 'sub-standard' loans should be 60%
 - The ECL of secured 'credit-impaired' loans should be 60%
 - The ECL of unsecured 'credit-impaired' loans should be 80%
- Allowing that all loans made in Mainland China and from the Rest of the World are secured (because we only have figures for unsecured loans booked in Hong Kong), we can extrapolate a more conservative level of ECL:

Category	Amount	ECL level	ECL
Secured 'sub-standard'	\$1.1 bil	40%	\$0.44 bil
Unsecured 'sub-standard'	\$1.1 bil	60%	\$0.66 bil
Secured 'credit-impaired'	\$0.9 bil	60%	\$0.54 bil
Unsecured 'credit-impaired'	\$2.6 bil	80%	\$2.08 bil
Total	\$5.7 bil		\$3.72 bil

- That ECL would then be 27% of its commercial property lending in China
- To reach the same level of ECL, HSB should raise its ECL by $(27\% - 3.6\% =) 23.4\%$ of its commercial property lending in China of \$30.4 bil, or \$7.1 bil
- If these losses then materialized, its equity would fall to \$16.4 bil, and reduce the value of HSBC's stake in HSB by 62% of that: by \$4.4 bil from \$14.6 bil to \$10.2 bil
- Neither Bohai nor HSB hold a loan loss provision against losses on residential mortgage lending

¹⁶ HSB 2022 annual report p. 86

¹⁷ HSB 2022 annual report p. 88

¹⁸ HSB 2022 annual report p. 180

¹⁹ HSBC Holding 2022 annual report p. 382