HSBC Strategy Day
Environment & Regulation

Speech by Douglas Flint
Group Chairman, HSBC Holdings plc

10 May 2011

Stuart, thanks very much. As Stuart said, this is a very opportune moment to be setting out strategy apart from the obvious point that it's a new management team, and indeed a new leadership team. It's a great opportunity to be setting out the strategy.

In terms of my role today, it's very, very modest, but just to say that the strategy you're going to hear from Stuart and the team has been set in the context of the Board agreeing the strategy and the Board setting the risk appetite within which the strategy has been set, so the Board endorses what you're about to hear; has heard it consistently over the last three or four months as it's been developed, and we're looking forward to hearing the presentation here today with you.

As Stuart said, this is an opportune time because the regulatory fog is beginning to clear, but it's also an opportune time in the sense that we're beginning to see economic growth come back, not just in the faster growing markets continuing to be strong, but also improving in the mature markets, and particularly seeing recovery in the United States.

We're seeing financial markets functioning again with good liquidity in core areas. We're seeing market confidence illustrated by a resumption of merger and acquisition activity, and we're seeing some of the legacy positions and some of the legacy activities, steadily and progressively running off.

However, the context in which the risk appetite of the group is set, is that there are still headwinds out there. The fiscal deficits in mature economies, the US housing market remaining fragile and volatile, and elevated commodity prices which are having impacts both in the mature and in the emerging markets and with inflation risk evident again across both sets of markets. The continuation of low interest rates has been very important to economic recovery and the resolution of over-indebtedness, and clearly the next movement is up - but on the other hand, that's good news for a bank with a very high surplus of deposits - and the regulatory change programme is significant.

Looking at that regulatory change programme, we think that we're in the process of a major change, but this change has been going on for some time. The good news as we enter 2011 is that many of the transition rules have been clarified and many of the metrics that we've been discussing for over five years now are beginning to seem as if there is some substance to them, particularly in relation to capital.

So, much has already been achieved in the direction of travel, and even the destination is beginning to become clear.

Having said that, 2011 is going to be marked with a number of areas that we still have to clarify, most particularly in the area of liquidity and funding where a great deal of observation is still taking place. A great deal of discussion is taking place as to how the funding and liquidity model will be made to operate globally and indeed, within key national regions.

Globally systemic financial institutions, of which HSBC is clearly going to be one, the formulation of how they're going to be identified, how they're going to be regulated and supervised and what potential penalties or additional capital they may have to hold, should become clearer towards the third quarter of this year. As I said, we're very clear that we will be one. I think that debate is over, and the issue that we have is how many institutions will be so classified, because that will have an impact on whether it becomes an advantage or disadvantage. Our own view is that being so designated in the long term is likely to be an advantage for the institutions so classified.

Also, we're going to see the regulatory frameworks bed down in many of the major regions of the world; in the United States Dodd-Frank; the European region through the Capital Requirements Directive; Basel III; the new European banking authority; and also what the UK does in relation to the transition to the new regulatory framework and to the Independent Commission on Banking. We're very concerned to understand and to input as to the level playing field implications of all this parallel regulation coming in at the same time.

Similarly, both in the US and in the UK, but now in Europe and also in Hong Kong, the development of recovery and resolution plans all have the same direction of travel, but are being done slightly differently and again, harmonisation is something that we're inputing, and so, there's a lot to be done in relation to inputing over the next six, 12 months or so, in terms of clarifying the final aspects of the regulatory framework, including in the use of central counterparties and how derivatives contracts will be handled around the world, and particularly in relation to margin.

If we look at the Independent Commission on Banking in this country, a lot of progress has been made and we welcome many of the things that have come out. The capital ratio of 10 per cent, the indicative 10 per cent capital ratio is very much in line with what we expected, as we said when we presented results at the beginning of the year, but we're waiting to see how much bail-in debt we're going to have to hold and how that will be classified and clarified.

The ring-fence proposals are again what was expected, but are very much work in progress in terms of how the perimeter is defined. And in particular, although there's been a great deal of focus on the capital position of the ring-fenced bank, how the inter-relationship between the ring-fenced piece, and the rest of the Group – in particular in relation to liquidity and funding – will actually settle down. The competition aspects we have no difficulty with and we look forward to a more competitive framework.Again, we're alert to whether there will be a level playing field between the UK and the rest of Europe and other banks who operate through branch structures in the UK, but that debate is well under way and the dialogue is very constructive with the policy makers in this country. So again, an intensive consultation period ahead of 4th July, and the publication of the final report, but I think we're very encouraged that the dialogue is constructive and that both sides are listening to each other in relation to how the objectives and the direction of travel can be operationalised.

As I think of the whole regulatory and economic environment, I am very encouraged that we as a Group are very well positioned. I think while a lot of discussion and talk has been seen in the last several months about the change at the very top of the organisation, one of the things I'm particularly proud to be associated with is that something like two dozen of the more senior positions in the group have been refreshed over the last three months since Stuart took on his role: the same people in the Group, but taking on new and expanded and different roles, and all of that being done, or most of that being done from internal resources.

I think that is a fantastic achievement to be able to resource that kind of succession internally and it's that management team you're going to see today that represents that change.

We already have a very strong core capital position, but more importantly, we continue to generate capital and continue to generate capital after making cash dividends.

Iain's going to be talking about the impact of Basel III changes; and mitigating steps that we can take or are in the process of taking as the Basel III framework is progressively introduced; to things that we are going to be able to do to mitigate some of the pro-forma aspects if it were applied today.

I think most importantly, as I look at the regulatory framework and the direction of travel of change, while capital is going to be important, liquidity and funding, I think, is going to be the core comparative competitive edge in the banking world as we go forward.

As you know, we've always operated with strong liquidity and a conservative approach to funding. It's probably been even more pre-eminent than our capital approach. This doesn't need to change in the new framework and the funding and liquidity that we've got is very much in the faster growing markets that are being targeted for growth, and therefore, I think that gives us a range of opportunities, because of the fact that we have funding and liquidity in the place that we want it, that we can deliver against the opportunities that Stuart and the team are going to describe.

And finally, again, as the regulatory landscape clears, and people think more and more about loss, given default in the event of institutions having to be recovered or resolved, our geographical subsidiarisation structure offers, I think, material advantages and discussions, particularly in the implications of recovery and resolution plans and the implications of ring-fencing and so on, that there is a framework that has a very rational – a rational route to dealing with difficulty in the event of recovery and resolution.

And I think – I hope and I believe that that will pay dividends in terms of capital burdens that may be imposed.

Anyway, at this point, enough from me. I want to hand over to Stuart and his team to deliver the strategy.

Thank you very much.

HSBC 2011 Investor Day

Group Strategy

Presentation by
Stuart Gulliver, Group CEO, HSBC Holdings plc

11 May 2010

This is actually the second time we've had an investor day. The first time was in 2007 which lasted for approximately two hours. Today, we've set aside a whole day, and I think it's important for us as a new management team to set out, in essence, what we intend to do with HSBC.

The financial strength of the firm you're very familiar with; our liquidity and our diversity protected us from some of the worst instances of the financial crisis, and in many ways ensured our share price was less volatile than others.

But the reasons for holding our stock in a crisis become less relevant in recovery and I think, in our view, we now risk losing ground to more agile competitors. Or, to put it another way, we're a very large firm that delivers significant profits, but we're complex and historically, we've struggled to tell a coherent story about why our shareholders should own us.
And we hope that the start of these annual investor days and, with quarterly interim management statements, we'll be able to communicate more readily to you what we're actually trying to do with the firm.

So, today, I am aiming, really, to do five things, and we are trying to make an investor case here. We're trying to set out what our strategy is and then basically, talk to you about how we're going to improve our capital allocation and our costs and accountability.

We're going to set out the distinct position for HSBC and why we think we sit amongst some of the most powerful trends that are taking place in the global economies in the 21st century.

We're going to be honest about the particular challenges that we face, including our cost challenge and our ROE.

We will hopefully articulate a clear strategy of what we're trying to do, and why we will position HSBC to be successful.

We should be able to give you confidence as to how the team will execute on this.

And we'll take you through in detail the framework we're going to use to allocate capital, the type of things and programmes we'll put in place to address our cost base, and how we intend to keep the financial strength of a geographically-subsidiarised bank, which we think in the context of the regulatory environment is absolutely critical, but without the increased cost of wastage which arises when that structure becomes federal.

Now, I've no doubt about the scale of the challenge that we face, but I equally have no doubt about the ability of my team to deliver. The market should not expect a list of radical news items today, notwithstanding what's been trailed in the press, but rather an understanding of how we will run the firm, so we'll set out a framework, but we will also publish as we go into the detailed customer group and geographic presentations, return on risk weighted assets targets by country and by customer group, which is a first for us.

We'll set out clearly the cost saving target, and I'm also going to publish a scorecard against which I will be accountable, so when we come back in a year's time, having taken interim stages of review at the quarterlies, we'll be able to check the progress of this team against that scorecard.

First of all I want to dispel a couple of myths and provide some context.

And this is important because the strategy really sits around international connectivity and wealth creation and the connectivity goes to our network. I don't think our network has been well explained historically.

This is actually a picture of Mexican dollar issued by the Shanghai branch of HSBC at the end of the 19th century. This bank was set up in 1865 in Hong Kong and Shanghai to finance trade. It was set up to finance trade between Hong Kong and Shanghai, and France, the UK, Japan, India and the United States. Those are the original operations that were opened for HSBC, so this firm began as a commercial bank, and in fact, what we now call CMB is effectively the current manifestation of that trade finance, commercial banking core skill set. In fact, it was Commercial Banking that led to personal banking. Once you start banking individuals who have firms, you do their personal banking. As they get successful, you do their private banking. As those firms get bigger, and actually, there are several examples in Hong Kong of this, you eventually do their wholesale banking, their foreign exchange, their derivatives, their bond issues etc. So the heartland of HSBC is commercial banking.

Now, sometimes, we struggle to explain why we're in 87 countries and, as a result, we're unfavourably compared to some of our peers. And actually, I think this is because we have allowed the market to view HSBC through a retail banking lens. No doubt, this is reinforced by our marketing strapline, the world's local bank, and the fact that most analysts and most portfolio managers sit in the two markets where we actually have the scale to be a very profitable retail bank, namely the UK and Hong Kong, so they see our branch network all around them.

But actually, Commercial Banking and Global Banking and Markets, both of which have been built organically, contributed over US$54 billion of profit before tax between 2007 and 2010, so during the height of the worst financial crisis since the 1930s. And they both rely on the network – the network of branches that we have and the position that we have in 80 plus countries. And I strongly believe that we do actually benefit from a network effect, precisely the thing that Metcalfe's Law describes with phone networks applies to 87 countries with Commercial Banking and Global Banking and Markets, with significant clients in those countries.

As I say, historically, we've not actually projected Commercial Banking and Global Banking and Markets as the reason for the network. But actually, the network's critical to both. Retail banking does not need the full network. It never did. And today, we'll provide clarity as to how to think about retail banking in the future, and our plans to build a new wealth management business with a focused, precise set of personal banking customers. We'll show you where it's important and where it's not.

Going forward, do not mistake the marketing strapline, 'the world's local bank', for our strategy. So I'd ask you to look at our network and consider its values through the lens of Commercial Banking and Global Banking and Markets. And therefore the trends in world trade, GDP and demographics, which I will turn to shortly become immensely important and present a massive upside to this firm which we will capture.

This firm has a terrific trading heritage. It sits with exposure to significant growth markets and actually, we have the financial resilience to deliver against those opportunities.

Let's have a quick look at our share price. As I said before, we are a firm that produces significant amounts of profits, but struggles to tell a coherent story to our investors. So therefore, we have tended to be broadly flat against the market for actually the last 11 years. The share price has gone broadly sideways for 11 years.

We outperformed the market significantly, actually, for the prior period. Now, clearly our resilience through the crisis has been important to shareholders, and our dividend payments have also been important to shareholders. But, if you look at our dividend payments, we paid out US31 billion in the last four years. That makes us the second highest in the industry globally. ICBC is higher than us. But it's equally clear that paying dividends is not enough because despite paying those dividends, the share price has essentially remained at £6.50. So we clearly need to articulate much better the growth story that HSBC can take advantage of and deliver to you as shareholders.

I think it's also extremely important for you to realise that the senior management of the firm have substantial shareholding themselves in HSBC stock. Most of you are aware that I voluntarily have built up a substantial position in HSBC, but if the new LTIP is approved at our AGM, all of us in the top team will be long term holders of HSBC shares and unable to sell them until we retire. So we therefore believe that we've designed a compensation system that reinforces the alignment between management and long term shareholder interest and we think that is actually extremely important. So what we hope to communicate today is both the long term vision, but also in the short term, some of the action steps we clearly need to take to progress along that journey.

So, let me start to try and make the investor case for HSBC.

Our strategy in essence is stored around two main elements. One is international connectivity. We have basically assumed that the major economic regions and financial hubs of the world, and the linkages that exist today in trade capital flows, will continue to grow. And I will talk about this in a little more detail in a moment.

We also believe that the rebalancing of the global economy, from the developed world to the emerging markets, will continue. Indeed, we believe that 19 of the 30 largest economies in the world by 2050 are ones that we today describe as emerging markets, but are also ones in which we're positioned.

And we also believe that if you consider that the world's connectivity will continue (and as I say, I will make the case as to why I think it will continue in a moment) and you believe that the highest growing markets sit in the emerging markets, but that the developed world would continue to trade with them, then we believe that you would also want to invest in those opportunities with a financial institution that has the hallmarks of financial strength, liquidity and capital that HSBC offers.

Let me outline in a little more detail the macro trends that we think are at the heart of owning HSBC.

Trade will continue to grow. Trade is forecast to grow between 2000 and 2020 by nearly nine percent per annum. The sources of these assumptions are in the footnotes. Now, this is an area of natural strength for HSBC, given our international network and given our trade finance heritage.

Imbalances will continue to drive international capital growth. By 2020, total global funding surplus is forecast to be US$21 trillion. But actually, the most of that sits in Greater China, Japan, Germany and the UK. The UK will move from deficit to surplus during that period according to our assumptions.

The capital markets will enable economies to obtain the required financing, but if you look at this, it is impossible for countries to retreat from global capital markets. They just can't fund themselves, so any notion that protectionism will end any of these kind of global connectivity arguments, I think, is implausible. It's hard to see how the US can finance itself without being involved in global capital markets. There is a structural imbalance. That structural imbalance will exist for the foreseeable future. That structural imbalance offers capital, FDI and trade flows, which because of our geographic footprint, because of our network, we're actually uniquely positioned to take advantage of.

Having said that, the world is actually surprisingly concentrated. If you dig into trade flows, 35 countries account for 90 percent of growth in trade flows over the next ten years, and that also holds true for external debt, bank profit growth, wallet available for bank profits and indeed, FDI.

So, actually, it's not about being in 200 markets. Again, I often find that one of the things being put to me is, "Well, if you're the world's local bank, you know, being in 87 countries isn't enough. Look at it from the other point of view." Actually, it's quite concentrated, but again, bear in mind the network's vital for Commercial Banking and Global Banking and Markets. But as you will see as set out, the individual geographic presentations, which will focus a lot on the growth opportunities and the customer groups, you will see that we are not going to try to be all things to all people in all markets.

The other trend I think that is absolutely set in train is the rebalancing of the world economy. Now, the centre of gravity continues to re-balance towards what are currently called emerging markets. By 2050, as I said earlier, we believe that 19 of the top 30 economies will be those currently deemed emerging markets, and these are all countries in which we already operate. The cumulative group will be massive and HSBC gives you access to that, and actually to the appreciation of their currencies.

The key thing about the fact we've been in the places a long time – and this is incredibly true about Asia Pacific, about the Middle East, about Latin America – is that trust and relationships are at the heart of business. These are not parts of the world that have institutionalised their business processes in the way the United States and to some extent, the European Union has.

Having said that, the developed markets will not become irrelevant any time soon, and it's really not a simple zero-sum game here. Many developed markets remain incredibly important, both as trading economies and as centres of wealth. The key point, therefore, is that we will continue to sit in both the developed world and the emerging markets. We do not believe it offers the full opportunity to simply become an emerging market bank. Our European business is actually incredibly important to us.

If I could just step back for a second, to over-simplify the world, there are four big economic blocks. There's Japan, the United States, the European Union and the emerging markets that are in essence driven by China. We have substantial presence in the emerging markets, driven by China. We have a substantial presence in the European Union. We need to stay in both so that we can involve ourselves both in the emerging market to emerging market trade flows and wealth flows and capital flows, and the developed world, European Union to emerging market flows. Every time that I go and meet the CEO of a major corporate in France or Germany, they're investing and they see their growth opportunities in exactly the same markets that we have a footprint in.

As this economic shift takes place, there will also be a substantial change in where the wealth creation takes place in the world, which is partly what our wealth strategy is about.

You can see in the middle graph those markets expected to have a GDP per capita above US$35,000 by 2050, and the reason I've chosen that level of US$35,000 per capita is that's the current GDP per capita of Hong Kong. The reason I say that is to illustrate an incredibly important point. The power of income per capita growth can drive bank profits.

Over the past 40 years, GDP per capita in Hong Kong increased 31 times from US$900 a head to US$31,000 and our Group profits, just in the last 18 years have increased seven times. You as analysts and owners are aware of the extent to which Hong Kong has driven HSBC's profit growth, so if you look at where the potential new wealth creation is and just look at the multiples of growth of income in places like China, India, Mexico, Brazil, Turkey, you can see that wealth creation in the emerging markets will be a fast growing phenomenon that will take place over the next five, ten years. And again, we have access to those clients and therefore, give you as investors access to that opportunity.

But, we do believe that the best vehicle to express this through is one that has the type of financial profile that did enable us, for want of a better expression, to have a good financial crisis. In other words, we have deliberately created a business that's diversified by customer group and diversified by geography and actually has an A/D ratio substantially below 100. We've given guidance that 90 is the ceiling (we actually at the first quarter reported that our number was 78.2) and we are not going to change that.

We think it's incredibly important to have retail deposits in order to not find yourself in a situation that happened to a number of our competitors. I think we'd all recognise that a number of competitors actually ran out money as opposed to running out of capital, so if you're reliant on the wholesale market, you're reliant on a massive sentiment shift that can take place very, very quickly. This is critical. We continue to have a substantial surplus of deposits over loans and that will remain the case.

Our geographic diversification is important to us. This will continue, by definition, given that these economies in the emerging markets are faster growing, and continue to shift the balance sheet towards the emerging markets. But we are not going to pull back in the UK, France and Germany, any time soon because we reckon they are incredibly important to the connection between the developed world and the emerging markets and I'll talk a little bit more about that in a moment as well.

Our financial strength also has enabled us to deal with some pretty hairy problems which we were able to take care of ourselves internally without resorting to any government equity or debt from any government anywhere in the world. And that, frankly, has been a very real stress test, so the financial strength of the firm to manage its way through both the sub-prime problems of household and actually the SIVs and conduits in global banking and markets. I think it's proof of concept of the financial resilience of the firm.

Now, clearly, to deliver against this in a meaningful way short term for you as shareholders, we have to improve some things quite substantially.

We've got to improve the way we deploy capital. As Douglas said, our tier one ratio, we believe as a global SIFI, will be between 9.5 and 10.5 percent under Basel III based on the information today.

At the moment, we delivered a 9.5 percent return on equity in 2010, and we set guidance of 12 to 15 percent. Now, that guidance of 12 to 15 was based on a bottom-up calculation of return on risk weighted assets by customer groups and geography applying Basel III to get to that return. So although I've seen this morning on some of the newswires the view that 12 to 15 is too low, we only set it two months ago, and it was done with quite a lot of mathematical science. And I can assure you, if we manage to get outside the top end of it, we will be equally delighted. But the 12 to 15 is quite carefully calculated and thought through and Iain will talk a little bit more about this in his presentation. But we are going to be hard-nosed. We're going to be disciplined about the way we allocate capital.

We also need to do something about our costs. We clearly have a cost problem and I will talk in a moment about the programmes that we've put in place to bring costs down. And we obviously do need to get the ROE of the firm up. But as a number of you pointed out after the results, on the one hand, there's a group that thinks 12 to 15 is too low. On the other hand, at 9.5 we're US$4 billion short of getting to the 12 with our 2010 numbers, so there is a challenge in there marching towards those numbers in any event. But we will deliver towards this, and this team will address the issues of the firm with some energy.

So, having described our distinctive position, let me move to the right hand side of the slide.

I'm now going to set out our strategy and explain why you should be confident that we will execute against it.

There are three key elements to the execution part; clarity of vision; more efficient capital calculation (and I'll set out the strategy and how we will make capital allocation decisions both now and on an ongoing basis); and the action plan to deliver the cost and accountability.

As Douglas has said, I've actually made 24 changes since I became Group CEO on 1st January. The important thing about those are both that this is a refreshed and new team who are going to act cohesively to drive this forward. But also, most of these came from inside, which shows the bench strength that this firm has built up and I actually think is a tremendous strength of the firm.

Rightly, ultimately, the responsibility for delivering this strategy will fall on me, which I'm perfectly comfortable with, and as I say, we will set out a scorecard for which I'm perfectly prepared to be held accountable at the end.

So what is the strategy of the firm? The goal is to be the leading international bank.

This is a really important slide so we need to spend a bit of time on this. There are two main elements to what will drive the future shape of HSBC and its strategy.

One is this international connectivity point, the case being made by the macro trends that I showed you earlier.
It's therefore important that we continue to have a substantial network, because the way you take advantage of this is through Global Banking and Markets and Commercial Banking, and, to be crystal clear, to be the leading international bank is a goal. It's not a marketing strapline. It's not a piece of jargon. It's a goal. It's also a realistic ambition and it forces us to take a sharper focus on what we're actually doing, so presence in key markets matter for international connectivity. If you accept all those trends about trade, capital flow, wealth creation etc, you need to sit across those geographies where the considerable economic growth will take place in the next several years, and we do.

The second thing that we're going to focus on is that we will now limit Retail Banking only to where we can achieve scale as a full-scale retail bank.

This means that we're going to segment, and Paul will talk in detail about this, our Retail Banking operations and categorise them very, very specifically into different-sized opportunities.

Large scale positions such as Hong Kong and the UK have profitability, have scale. There are some very high growth markets which we will continue to invest in like Mexico, Singapore, Turkey, Brazil. There are some very small countries actually which are just fine like Panama and Malta. The USA is a specific issue that I'll come back to a bit later. Then, there are countries we need to invest in for the future like India and China, but actually India's PFS business has not been particularly successful and that's one of the reasons that we took RBS's network there. It's part of a restructuring exercise that needs to take place. You'll then find we're left with about 39 countries that don't fit into any of those parameters, and Paul will talk a little bit more about that.

There's a second thing, though, that goes on within this area, which is effectively the growth of a Wealth Management business and I'll come back to that in just a moment. But these two big drivers; the network effect which sits across international connectivity for Commercial Banking and Global Banking and Markets; and the need to reposition Retail Banking and the wealth creation sphere.

Two big blocks with effectively Commercial Banking and the network in the first and the restructuring of Retail Banking and Wealth in the second.

So, how are we going to decide how we use the money?... and this I think is really, really important. We've already introduced a process that internally we simply call five filters. We need to improve the way we deploy capital to achieve this profitability target of 12 to 15 on equity by 2013, and we've already launched a review of our businesses, assessing each one based on these five filters.

The first one, not surprisingly is international connectivity. Does this country (and do the businesses in this country) trade and connect with any other country that we're involved in in any meaningful way, or is it totally standalone so there's no connection whatsoever? A totally standalone business would be US Household, with no connection whatsoever to any other customer group of HSBC.

Number two, is it in a country whose economy will matter over the next 20, 25 years or is just a small country that frankly will still be a small country, or is it one that actually is going to really be part of the global growth story?

Having established that, we then dig into the second set of filters - are our current returns attractive?

So number one, do we have a decent ROE that's in the 12 to 15 range?

Number two, is the cost efficiency ratio in the 48 to 52?

And number three, does it fund the Group?

My earlier point was about the deposit base being incredibly important: we might have a country that was having difficulty on the first two, but was a huge source of deposits to the Group. It would need to be a huge source of deposit for a G3 currency because we actually run our liquidity by currency group silo, but it's possible that that may happen.

So, you can therefore see the way the filters will work. If you dig into a country that's highly connected and will really, really matter – and say that's France - when you dig into that and you decide that in fact some of the profitability and efficiency measures aren't quite there, then that's one that you're going to turn around and improve. You need to do some restructuring work. It's critical. Its connectivity's there. It's going to be in the top 30 economies in the world, but the numbers just aren't there. It needs some work on it.

If you look at one that has high connectivity and economic development and all three are there, then you're going to invest, and actually an example of that is the build out in Germany of our Commercial Banking business which we've started to do. Germany is the only OECD country that's grown its share of world trade over the last 15 years. Equally, we continue to invest in Turkey and in Brazil for exactly the same reason; all five boxes work.

When you look at some other countries, they are medium or low in terms of their connectivity to the rest of our network, or indeed, their economic relevance at any point in time. So if actually they happen to drive high achieving profitability, efficiency and liquidity, then we may well continue as we are. Panama and Malta would be examples of those. They don't hit the strategic relevance, but actually their ROE, their cost efficiency ratio and their A/D ratio are perfectly satisfactory.

Then there's a bottom set that aren't going to hit any of these. They are low in terms of their strategic relevance and they're just not delivering the freight, and in those, we're going to have to decide whether we can absolutely turn them around, which in most instances is very unlikely to be the case, or we're looking effectively at disposing of them or shutting them down. And there's a live example of some of this work already happening, which is the exit from Retail Banking in Russia.

Now, as I said, we're not going to announce a whole set of these today for rather obvious reasons. But if you look at the five filters, you can kind of work out directionally where this is going to go, and what you will be able to do is when we do make announcements, refer back, so you can actually see there's a logic and a framework to how we're driving forward the allocation of capital in order to get to the 12-15% return.

Now, costs… and this is really, really important.

We have stated here today we're going to take out US$2.5-3.5 billion of sustainable cost saves over the next three years.

It's going to take a while to do this because it requires us to re-engineer a bank that's been run as a reasonably loose federation,. It's also going to take a while because it's actually just a very large firm. But clearly, if we can deliver this sooner than this we will, but the US$2.5-3.5 billion we're confident we can deliver.

Now, it's really important to focus on the fact that this will be driven through four different main programmes and I will talk a little bit about each. In order to make sustainable saves, we have to look at re-engineering our business, rather than the traditional HSBC way of managing costs which has generally been to cancel the newspapers, being incredibly mean about travel and, you know, restricting people on how much laundry they can put into a hotel on a business trip. We really, really need to look at a substantial re-engineering of how we approach things. It takes an awful lot of socks to get to US$2.5-$3.5 billion, so we really, really do need to look at a couple of things.

We do not have consistent business models in what was called Personal Financial Services and now is called Retail Banking and Wealth Management. That means, therefore, that we have multiple propositions, we have multiple marketing groups, and for example, as a result of that, there's multiple demands on IT to write systems with huge amounts of local idiosyncrasies in them which clearly puts up the costs.

That's another reason why I put Paul in charge globally of Retail Banking and Wealth Management. Prior to Paul being appointed, there was no single global head of PFS, and therefore, you got this immense local richness and colour which hugely increased our cost base, because you've got multiple product propositions, and multiple system deliveries that have to take place.

Although it's less pronounced in Commercial Banking, it would also be true in Commercial Banking that we don't have one single business model. One of the reasons why Global Banking and Markets has a cost efficiency ratio of 49, is it does have one business model because it's been run as a single global business now for a very long period of time.

The second thing we're going to need to do is to streamline some of our IT processes. We have compounded the challenge of our IT costs, as I say, by not designating a very, very defined consistent target operating model for PFS and CMB which has made the IT challenge harder for our IT colleagues. And as Sean will talk about, we look pretty good because we've now benchmarked ourselves, using some external consultants, on the cost of our IT function in terms of running the bank on a day-to-day basis. But in terms of software development and development of new systems, and partly for the reasons that I've just outlined, we don't look best in class. So there's some work that needs to take place there.

We also need to look at our regional head offices. We have a whole lot of multiple head office and control structure that come about as a result of being organised by customer group, geographies, regional head offices, legal entities. There's work going on again, and it is true that we have brought in Boston Consulting Group to help us look at what's best in class in this regard, at de-layering, and Iain and Sean will take you through these. But as I say, there are some very clear things that we need to do to drive this forward.

Let me talk a little bit now through the customer groups and the countries and then I'll pass on to Iain to talk you through the financials.

So, let's look at how we'll execute this strategy in each customer group.

I'll start with Global Banking and Markets. Clearly, the key challenge here is more capital is applied against the business as we go to Basel 2.5 and Basel III. We're going to have to work harder to deliver target returns. But the other thing I really believe, actually, having run this business for a very long time, is we need to do a much better job of explaining to you the nature of our customer facing Global Banking and Markets business outside of Balance Sheet Management.

At present, this business attracts about the same P/E ratio as BarCap and Deutsche Bank, but it's actually a very different business. It's client facing. It's involved in traded liquid markets, and it has an unparallel capability in emerging markets which we believe strongly is the major growth engine for the world.

This business has been grown organically. It's produced US$30 billion of PBT during the last four years when many of our competitors actually were loss making. And what's also happened, and Samir may well talk a little bit about this as well is, we think we've re-established a base line for this of about US$9-10 billion of PBT. Pre-crisis, this thing ran at US$5-6 billion, which tends to evidence that we've probably captured a sustainable market share advantage during the financial crisis.

Commercial Banking: as I said before, this is the absolutely the heartland of HSBC. This is the DNA of the firm. It always has been and always will be a massive jewel in the crown for HSBC which has incredibly high barriers to entry and the reason it has high barriers to entry is, you need the network I described earlier to do this. If you want to be relevant to a manufacturer in France or a small manufacturer in the UK who's looking to do business in Argentina, you need to be in Argentina. It's no good being in Birmingham and helping them from there. You need to be in both places, so the network effect creates a massive entry level barrier to this. And we believe strongly that global trade will continue to grow and these kinds of trends are in place.

This business already has a cost efficiency ratio within the group's target and Alan will talk about return on risk weighted asset targets that we're moving to.

We've renamed Personal Financial Services as Retail Banking and Wealth Management and actually there is significance to this. I know there's a deep cynicism about large institutions renaming things, but let me explain why we have renamed things.

First of all, there's two distinct pieces here. There is a new business which is building out Wealth Management because we do think the trends that I set out at the start of the presentation offer huge potential for HSBC. It's going to be focused. Paul will focus effectively on 18 markets, not on 87 markets, where we believe that the opportunity is the biggest to deliver Wealth Management. But we do think that actually this Wealth Management opportunity works for us, because we're in the emerging markets which have got the fastest wealth creation. They have the highest savings rate of any countries anywhere in the world, but actually, even in Europe, there are significant unfunded government pensions which means people will have to save for their own retirement which will again create a catalyst for the contractual savings industry – which is actually what nearly all of us work in. So we can see both in Europe and in the emerging markets, a considerable growth, therefore, for Wealth Management.

Retail Banking: think of this separately, it needs to be segmented, and as I said earlier, you've got evidence of what we will do when we discover a sub-par retail portfolio. We'll exit it, which is just what we did in Russia, so Paul will take you through in detail how we'll look at the various different countries. As I say, this has been renamed, but it's not a form over substance. It's been renamed to make it very, very intellectually clear to you there's a Wealth Management strategy which involves insurance, asset management in about 18 countries and there's a restructuring of our extant Retail Banking businesses which will take place at the same time. Don't mix them up.

In Private Banking, it's the same point as Wealth Management. This should be a massive growth business for HSBC. We are sitting in the fastest growing wealth creation in the world. That sits obviously in Latin America, in Asia Pacific and in the Middle East, and actually we have a brand that's trusted, and therefore, this is a natural extension of what I said earlier. If you think back to Commercial Banking at the hub, if you've built your own business as an owner/manager, and you eventually list it, you have that wealth event that creates the Private Banking opportunity and actually, an awful lot of the Private Bank referrals as Chris Mears will talk about, come from actually within HSBC.

Now geographies. This is very, very important.

We have a business in North America that is run off in respect of Household, but we do not believe that just letting Household run off gives us a strategy in the United States.

We also believe it's absolutely critical to remain in the United States. The US is still the biggest source of investable funds and is still the world's largest economy, so we have absolutely no option but to be in the United States. It's also the case that the US dollar is the world's reserve currency and the main payment currency in the world.

What we need to do is to re-position our business to be relevant to the United States, and let me talk, first of all, a little bit about the end vision and then about some of the restructuring action that will take place.

The only way that we can add value in the United States is actually by connecting into the other countries in which we operate. We can't compete on a domestic agenda in the US against the four big American banks that have got much bigger. So the opportunity lies in Global Banking and Markets, but connecting that in America. The opportunity lies in Private Banking domestically onshore, but also with Latin American clients. The opportunity – and this is the new focus actually – lies in Commercial Banking and fits also with the fact that the US (there's some interesting work that the Brooking Institute has done on this) is rebuilding its manufacturing industry and looking to expand its export and trade, and it's trade where we have the expertise. It's trade where we bring something to American clients that actually, we genuinely believe we have more skills in than the American banks, and so the branch network needs to be repositioned, therefore, to fit where the renaissance of US manufacturing will take place.

We also believe the US will probably have some of the cheapest energy sources of any country in the world as it starts to fully bring out its shale oil and gas. Therefore, actually, we are quite bullish on the US economy and quite bullish on the manufacturing opportunity, so therefore we have started a strategic review and I'll let Niall talk about it in detail.

No decisions have been made as yet. But we have started a strategic review, and within that the card business is not strategic. Go back to the five filters. Those are store cards and subprime or exiting. With store cards you don't get to the client so there is no cross-selling opportunity. It is not strategic to us. However, we have lots of capital and lots of liquidity, so we're also not a forced seller. But if we're going to be disciplined about the five filters, we need to look at this, and Niall will talk a little bit about this, and also some upstate New York branches that don't fit with where we think the growth opportunity in the US economy is.

Turning next to Latin America, the big focus for us is Brazil, Mexico and Argentina.

These are the three countries we want to focus in on. In Brazil and Mexico alone, there will be 35 million people moving into social-economic groups A, B and C by 2014. So again, there's a substantial Wealth Management opportunity there. There's also a substantial Commercial Banking and Global Banking and Markets opportunity – and we already have (which

Samir will talk about) a strong Global Banking and Markets capability in Latin America.

We have, however, a problem here where our ROE is below the local market and our cost efficiency ratio is higher than the local market. Emilson will talk in detail about this, but a lot of this has been about regional headquarters. And the restructuring charge that you saw come through in the first quarter actually relates to removing some of the cost base at the regional headquarters in Mexico City. So, we accept the fact that we need to do something – more than something. We need to sort out the ROE here, and sort out the cost base, but this remains, in terms of those countries, Brazil, Mexico and Argentina, an absolute top priority which do hit the five filters and we will continue to connect them to Europe.

As I said earlier, it's crystal clear to me that we must remain fully invested in the UK, Germany and France to drive Commercial Banking and Global Banking and Markets.

If we really want to capture the flow between the developed world and the emerging markets, so called North-South, we have to have a credible presence in those countries.

It's absolutely the case (and Andreas Schmitz, who runs our German operation, is at the back of the room) that if we want to do business with Volkswagen in China, we need to cover them with German colleagues out of Dusseldorf, covering them in Wolfsburg. It just works that way. The same is true of major French clients and Christophe de Backer is also in the room who runs our French bank. So to be crystal clear, the UK, Germany and France are key to Commercial Banking, and Global Banking and Markets.

The UK is absolutely essential to Retail Banking, and by the way, the UK retail bank cost efficiency ratio is not the worst in the industry. Actually, if you look at it, and you'll all understand this, there's an absolute inverse relationship between A/D ratio and cost efficiency ratio because interest rates are at 50 basis points. A bank with a low A/D ratio at the moment has a high cost efficiency ratio because it has no net interest margin on its deposits. So if you map it out, the guy with the worst A/D ratio has the best cost efficiency ratio because obviously he's borrowing from the Central Bank or the market at 50 basis points. It's completely inverted. A better way to look it, I might suggest, is to look at cost per branch and in that regard, we're completely competitive.

It is the case, though, across Continental Europe, that we need to do something about our cost base, and this again, is an area where we've got multiple layers of head offices. Actually in this building, there are two head offices. There's another one in Paris. There's one in Geneva for the Private Bank. There's one in Dusseldorf for the German bank and we have brought in Boston Consulting Group, again to try and get us to a position where we can see who's best in class, and what the journey would be to get towards best in class.

The Middle East and North Africa: obviously a very troubled part of the world in the first quarter of this year. Indeed, in the first quarter of this year, we've obviously had very sad developments in a number of countries in terms of loss of life in this part of the region. We've been here for 50 plus years. It's a core part of HSBC's DNA again. In fact, the original two banks are the Hong Kong Shanghai Banking Corporation and the British Bank of the Middle East, so we remain completely committed to the region.

You know, it has got 61% of the world's oil reserves. It has got 45% of the world's gas reserves. It has got a population, excluding Pakistan and Iran, of 265 million and actually, it has got also a huge source of investable funds sitting in its sovereign wealth funds So we actually think that this is a great business. It's going to go through a turbulent period because of political instability and there will therefore be some headwinds on revenue which are unavoidable, But if you want to talk about long term, this is the kind of place where HSBC's sticking power and staying power always gets rewarded when the good times return.

So this is a business which Simon Cooper, who is here, will talk to you in detail about, but it is one that we remain very, very committed to.

And, then last, the most important region for HSBC without any doubt: Asia.

This is the heritage of the firm. This is the history of the firm. Now, we have the potential here not only to connect the key economies with each other, but also with the rest of the world. This is our heartland and it's an area where we face significant inflationary wage pressures which I talked about on Monday and everyone's woken up to the fact that this is where the growth is.

We're now working to get a grip on cost. But we're not going to compromise on paying for talent, so this means managing down non-staff costs. And it means, again, that those four big programmes, to take the US$2.5-3.5 billion out, have significance even to Asia Pacific where we have some of the best cost efficiency ratios in the Group, because Peter faces considerable headwinds in terms of wage price inflation. You'll have seen that again in our first quarter IMS statement.

The two massive priority markets are obviously Greater China and India, and maintaining leadership in Hong Kong, and China as the top foreign bank, will help us to be number one in RMB – and the internationalisation of the RMB is a huge opportunity for this firm. We will defend our leadership positions in Hong Kong at all costs. You have to accept that. This is the heartland of the firm and we will do so, and so therefore, there will be wage price inflation. There will be cost price inflation there.

Our strategic investments in China have performed incredibly well, as with Ping An, for example, and we will continue to expand our BoCom partnership. We are at the moment studying a joint venture where we will look to work together with Chinese SOEs as they come overseas, with BoCom providing the China side of it, and our network overseas providing the international linkage. To be clear, none are for sale. We wish to maintain our level of exposure. Let's be clear here. We wish to maintain our level of exposure and commitment to China and these investments are, for now, the best way to achieve this.

India is also an incredibly important market to us. We will grow our business out in India at the pace that the regulators allow us to. The reason we took RBS's business is that gave us access to a number of branches that would have taken us years to get on a case by case basis.

Now we, as a management team, all accept that we're accountable to you for delivering this.

We're accountable to you to getting the ROE sorted out, getting the cost efficiency ratio sorted out and delivering on this strategic plan. Most of the Group Management Board will actually present to you today. The delivery, I know, depends on execution, and you are going to have to judge our ability to execute on this, and execution will be delivered by the Group Management Board under my leadership. At the end of the day we're all accountable and obviously I have primary accountability.

I've also brought together, so that you can meet them during the lunch break and during the coffee break, other members of the senior management team (and actually during the Q&As). You've got all the bios in your booklet and I want them to have exposure to our owners and to the sell-side analyst community.

I also mentioned briefly the importance of values in the execution of our strategy and right at the heart of this is an expectation that every employer will act with courageous integrity.

Some of you may have picked this up, but we started a big piece of work to define the way we do things at HSBC. We have clearly a very large institution. If I'm going to de-layer – and if I'm going to empower and decentralise and move from what's been a command and control culture, which is the origin of HSBC's culture – then we need to set out a series of values and principles that define the way we behave here. We need to be certain that we can delegate, with confidence, that the kind of outcome that will take place results in ethical behaviour and writing the type of business that we can be proud about.

So this courageous integrity again is not some happy-clappy strapline. This will be the basis on which we evaluate people. As well as every one of my senior team's score cards having ROE goals, cost efficiency goals, they will also have a rating in terms of their behaviour and the values, defined by courageous integrity with three further things that fold out underneath it which are dependable, open and connected.
We're actually doing values training for the top 300 people in the firm because again, to galvanise and motivate and drive a firm like this, it needs more than one person. It needs more than 12 people which is a Group Management Board, so we're cascading that down.

So, in summary, I think we have quite a distinctive position. I think we do sit across some of the major trends that are taking place in the world and there's two ways for us to deliver that to you.

One is through the network which is Global Banking and Markets and Commercial Banking.

The other is to drive forward a Wealth Management business and at the same time, we need to restructure our Retail Banking.

We clearly need to deal with our ROE and allocate capital in a hard-nosed disciplined way going forward, which clearly hasn't always been the case in the past. And let's be clear, the reason it hasn't been the case in the past is, we've always had massive amounts of surplus capital. It is only in a world that's moved towards Basel III that capital actually for HSBC has become a scarce resource. It is also probably the case that the federal structure enabled some inefficiencies to persist for longer than they otherwise would have done. And the third reason why it's probably not been possible to do this before is we were in the worst financial crisis since 1930. So the reason we're looking at it now, is because we can look at it now and we need to look at it now.

As I said, this is a firm that's consistently delivered huge amounts of revenue, but has struggled to explain its investor case to people, to make the case as to why HSBC is a stock that you should believe has growth potential. And, as I say, to be absolutely clear, we're going to take a rigorous, relentless approach.

We will be more disciplined on capital allocation.

We've got a programme in place that's already started to cut costs, and the management team accept they're accountable to you for delivering the result.

So this is an outline of a report card, and I'll talk a little bit more about this at the end of the day, but this is essentially what I'm prepared to be measured on and held accountable for, to execute against over the next two years. We clearly, each quarter at the IMS, will be checking back to this kind of stuff. It's quite possible that actually, if we made progress into these earlier than that period of time, we will revisit it and flex it to a more aggressive position.

But again, I want to give you some sense, quite clearly, of the fact that we as a team have a sense of urgency about the need to do this, have a sense of the need for intensity and are now, going forward, going to be much more transparent and open with you, the investors and the sell-side analysts, about what's going on here and what our ambitions are.

I will now hand over to Iain.

HSBC 2011 Investor Day

Financial targets

Presentation by
Iain Mackay, Group Chief Financial Officer
Sean O'Sullivan, Group Chief Technology and Services Officer

11 May 2010

[Iain Mackay]

Thanks Stuart, good morning.

We'll talk about three broad areas this morning as we dig into financial targets.

We'll talk about capital, bearing in mind again that we indicated at the end of the year when we announced results that we had an underlying assumption here of core equity tier 1 of 9.5%-10.5% under Basel III. That permeates the underlying assumptions here. We'll dig into detail in terms of return on equity and how we believe we'll get there, and certainly some of the challenges we'll face on the way. And we'll provide insight on business efficiency – how we will reduce the cost base and bring it back inside the range of 48-52% from a cost efficiency perspective. We'll take each of these one by one.

Taking capital first…
As we said at the end of the year, we expected to see a hit of somewhere in the range of 250-300 basis points on a proforma basis. As you can see, we've broken the impact down to three broad categories.

First, the risk weighted asset impact representing some 40% of the total; the most immediate impact is from the market risk changes with respect to Basel 2.5. Following this is a CVA impact and the correlation charges coming in early January 2013. These directly impact most significantly the Global Banking and Markets business.

Secondly, dual impact; this is a combination of risk weighted asset impact as well as capital deduction. These represent threshold deductions and deferred tax assets impact.

And thirdly, the capital impact: deductions in effect. And these details in this slide are the four main areas which we believe have a significant impact but, as you can see, they are much less pronounced than the other areas, and are phased in over four years.

So now we'll turn to how we mitigate the effects of this.

Again, when one reflects about how we did this at the end of the year, we certainly took a somewhat conservative approach, excluded mitigation and clearly did not reflect on capital retention through this period. So as I go on to this, I would point out that this chart really lays out how we intend to mitigate the effect and, in actual fact, many of those actions are already underway. Again, this does not reflect profit retention, so in no way does this represent a prediction of core equity tier 1 ratios either at the end of 2018 (or any other year for that matter).

Again, we've broken this down into three broad areas…

The first in 2011 where you see a 60 basis point impact in terms of the implementation of 2.5. This will be mitigated by running down the Global Banking and Markets legacy positions and the continued run off of CML. You'll reflect of course that CML's been run off for more than two years now. Together with these actions, we're going to reflect on the active management and exit of the correlation book.

Secondly in the period from 2012 to 2013, we see an additional impact of some 90 basis points as Basel III begins to phase in. This will be mitigated by continued data cleansing. Through Basel II, we've continued to look at models, data quality and cleanse and improve the data reporting in this regard which has yielded significant risk weight asset savings to Group over the last couple of years. That exercise will continue and will yield mitigating effects. We're going to reflect on the development of internal market based models as opposed to standardised approach as well as contract innovation, disposal of certain positions and the restructuring of a significant number of exposures through collateralisation, for example. Throughout this period as well, the runoff of CML and certain external equity positions within global banking markets continues.

Finally, in 2014 to 2019, we see the full impact of Basel III coming in, with a further 130 basis points runoff.

Again, this will be mitigated by the continued runoff of CML and other Global Banking and Markets legacy positions.
So in short, we are very comfortable that we can manage the changes that are represented by Basel 2.5 and by Basel III. It absolutely does not impact our ability to draw the Group through this period.

On the last chart, as I mentioned, we did not reflect capital generation. However, as you're all very well aware, the Group has a strong history in this regard and even through the worse financial crisis for the last 70 or so years, the Group continued to generate capital. Even in 2009, excluding the effect of a rights issue, the Group generated significant amounts of capital. As we go through the business presentations today, we'll talk specifically about how we continue – we've got the full capability and continue to generate growth and generate capital across our businesses.

Capital generation capabilities as well have helped us to cement HSBC's position as one of the top dividend payers in the industry over the recent crisis. Only ICBC stands above us in this regard. Throughout the cycle, we've seen a strong flow of dividends from our subsidiaries around the world and in February, we announced a dividend payout ratio target range of 40-60%. We're absolutely committed to staying within this range as we move forward.

So in summary, when you think about where we stand with respect to capital, adjusting smoothly to the Basel III requirements is well within HSBC's capabilities and, at the same time, we're committed to maintaining strong dividend in the range of 40-60% payout.

Turning now to the return on equity targets of 12-15%...

We've seen a significant recovery from the depths of the crisis to 9.5% in 2010. However, there remains a significant amount of work for us to do to obtain the 12-15%.

Stuart has already laid out the clear framework for allocating capital and for assessing and re-assessing our decisions in that regard. The strength and the connectedness of our international footprint will allow us to continue. Loan growth – especially in faster growing markets, as we have demonstrated over the last few quarters, as well as the focus on fee income, particularly in the trade and the Wealth Management areas.

Clearly a major element in driving returns is a renewed focus and discipline as it relates to cost efficiency and significant improvement in these regards. We stepped up the discipline and organisational efficiency and Sean will take us through some specifics in that a little bit later.

We'll also benefit from HSBC's strong liquidity position. In terms of where we stand on interest rates, we don't in the short term, see a significant increase in short term rates. However, due to that strength in the balance sheet, we do expect to see upside in terms of earnings as those rates move. And, at the end of year, we provided some guidance, which remains true today that, for four quarter point movements over those four quarters, we see somewhere in the region of US$1 billion add-on to net interest income. That guidance remains true.

So when you reflect on this, how do these targets of 12-15% translate in to an operational measure that we can run on a day to day basis?

We've reflected on this in the context of return on risk weighted assets on a profit before tax basis. When you translate this measure, as everybody jumps to get their calculators, one has to reflect on the tax effect and, generally speaking, that's around the 20% mark for the Group, quarter in, quarter out; and also reflect that this is on a total shareholder equity basis as opposed to only tangible equity. And you should consider also, non-controlling interest. I think perhaps the important thing which the vast majority of you realised is that all the information that you need to track on this is sitting within the annual report and accounts and of course the disclosures at the end of the year.

Across the piece, what our analysis tells us is that we've got to generate risk return on risk weighted assets in the 1.8-2.6%.

Let me reflect a little bit now on how we do that, both from a regional perspective and from a Customer Group perspective.

A few points of clarification: the historical data on this page you are well aware of. In terms of how we've reflected in the targets, and Stuart mentioned this, we've built in the impact of Basel III. Those are reflected in terms of how we build the targets on the right hand side of this page. We've also assumed a fairly stable economic and risk environment, an interesting assumption to make in the world at this time, but that's the assumption that underpins how we move forward.

By region, in some markets we're clearly performing well and in others, it's manifest that we're not. Clearly, North America is a drag and Niall Booker is going to take us to some of the actions which are underway in that region later on.

In Europe, returns will be depressed to a certain degree. We have the head office costs in this region. We have the effect of the bank levy. We also have a very significant Global Banking and Markets business which is significantly impacted by Basel III.

On the other hand, we've got Asia which performs incredibly strongly and we've got great confidence in terms of what our colleagues in Latin America and the Middle East can deliver.

Looking at this from a slightly different dimension, a customer group view, our main challenge with this regard is in the Retail Banking and Wealth Management space – again, reflective of what has been going on in the United States for the last few years.

But clearly, the continued runoff that's been managed very successfully by Niall and the team of the consumer and mortgage lending business will provide relief as it relates to risk weighted assets. More broadly, and Paul will outline this in more detail, our reshaping and remodelling of the Retail Banking and Wealth Management businesses around the world will clearly bring some benefits.

As I already pointed out, the Global Banking and Markets business is most impacted by Basel 2.5 and Basel III and as a consequence, you can see the effect on returns in this business.

I should point out one minor detail here is that there are certain items, like head office costs, like the bank levy, certain funding costs which are not fully allocated out to the Customer Group from Head Office and consequently sit within other segments; that's not shown here.

But taken together, reflecting on our regions and the customer groups, one appreciates the geographic reach and the diversified capability of the Group. Combining our strong balance sheet and HSBC's strong and improving underlying performance, we're absolutely confident that we can deliver the required returns for shareholders.

Over the course of this day, you'll hear from us about many of the opportunities for growth and certainly some of the areas in which rationalisation will be required. You'll hear about the investment priorities. It's capturing those very opportunities which will enable us to close the returns gap from where we stand today to the targets that we've set out. We own these targets and are absolutely committed to achieving them over the next two to three years.

Now moving on to costs…

The slide simply is a recap of where we stood at the end of the year. We went into this in great detail and at the risk of stating the glaringly obvious, outside fair value of own debt, downwards revenue on pressures and upward cost pressures is where we've ended up. I'm not going to go into this in more detail.

I'll reflect now on where we stand in a slightly more recent evolution as of the latest operating costs. We're certainly encouraged somewhat by the rate of increase slowing as it related to operating expenses between the fourth quarter of last year and the first quarter of this. However, we still saw headwinds.

Stuart reflected on the pressures that Peter and the team see in terms of compensation costs in Asia Pacific and we certainly saw that in a number of our markets with continued pressures as it relates to those aspects of our operations. And, most notably, the effects of the PPI provision within the United Kingdom: that was reflected in our earnings announced a couple of days ago.

However, what you can see is evidence of some cost savings beginning to tell, both in short term and long term, particularly as it relates to discretionary spend. However, this is clearly not enough and there is much more that we need to do in terms of addressing this cost challenge. How do we do that?

We've laid out the target of US$2.5-3.5 billion sustainable cost saves.

This is a cumulative process and we need to build increasing momentum around this. This will not be a one-off action for 2011, nor even a one-off action in any of the succeeding years, but this needs to become part of the culture and DNA of the firm. We've built a very robust pipeline of sustainable saves and in fact, in the four months that we've been working at this, we've made great progress towards filling a pipeline that moves us towards the lower end of our savings range. Not all of this will be realised in 2011 and work will continue to keep filling that pipeline.

However, I absolutely should be clear on this one point. This is not about shaving US$.5-3.5 billion off the cost base of HSBC. What we're doing is attacking the operating expense run rate as we exited 2010. That's what we're focused on and that's what we're working hard on. However, we're not going to stop investing in our businesses. As we execute the strategy, we're going to incur costs.

Now reflect on this. What this is really about is creating capacity for growth. It's about self funding investments. It's about creating a buffer against headwinds, like the bank levy and other pressures. It's absolutely about positive jaws discipline. It's about spending and investing within the capacity of revenue growth that this business generates. Positive jaws is an absolutely critical measure that we will focus on going forward; the results of our efforts will be reflected in the cost income ratio.

So this is about returning the cost efficiency ratio to inside the target range of 48-52% and Sean's going to explain how we do this.

[Sean O'Sullivan]

Thanks Iain and good morning everyone. I've been the Group Chief Technology and Services Officer since January of this year and prior to that, I was the CTSO of the UK bank.

So Iain mentioned our objectives are to improve our cost efficiency ratio and to support the achievement of positive jaws. But we also intend to become much more dynamic and agile by reducing management layers and the number of people making decisions, making it easier for our customers to deal with HSBC. Achieving our cost efficiency objectives will clearly be a big challenge and requires a renewed approach.

Now we're going to follow some key principles. Iain mentioned the most important, which is to deliver the sustainable saves that he and Stuart talked about. But we'll also pragmatically implement best practices, and leverage some of the key components of our One HSBC programme going forward. Stuart mentioned that we'll implement four key programmes to get the job done and these will be governed every month from the top of the bank. So let me go into each one of these in more detail.

We operate Retail Banking and Wealth Management in 61 countries around the world. But the fact is, and Paul will outline this later, that we generate most of the profit in 15 of those. We operate in CMB in 65 markets but we've utilised inconsistent business models around the group which has driven increased complexity and duplication in terms of organisational structures, processing and IT systems. Now interestingly, we've managed Global Banking and Markets on a very successful basis globally. When we put our mind to implementing global propositions such as World Selection or HSBCNet, we're highly successful.

So, we are going to implement consistent business models. That will allow us to standardise propositions around the Group, increase simplicity, reduce complexity and duplication.

We'll also enable the implementation of 20 key efficiency projects which we've kicked off in this area, including CMB relationship management optimisation which will generate US$50 million a year in annual cost savings by 2013, changing our retail risk management model where we implement consistent underwriting processes and truly leverage the Group's synergy and scale.

I want to talk too about re-engineering our global functions or Head Office areas. The historical growth of the Group has in fact lead to multiple layers and Head Office structures. Implementing consistent business models gives us a real opportunity to take a fresh look at the balance between local, regional and global structures. In fact, in the UK bank, over the last number of years, we've implemented such a programme and that will generate US$200 million in annual cost savings by 2012 of which two thirds has already been delivered. So going forward, we will leverage the UK programme. As Stuart said, we will engage with BCG who are helping us with a benchmarking exercise and we will right-size our Head Offices and optimise this balance between global, regional and local structures. De-layering initiatives currently being implemented in our regional structures will generate at least US$300 million a year in annual cost savings by 2012.

So if we look at re-engineering our operational processes, across the world, we have built centres of excellence for most of our operational and professional functions, such as payments, call centres, etc. However, there is considerable opportunity for us to standardise and really leverage the best ways of doing things. Frankly, there's a big difference in our firm between best practices and worst operational practices and there's a real opportunity there.

Now we do have a track record of process engineering. For example, in Brazil, we used to deliver deposits and cheques to 33 different locations around the country. We've now centralised that. It's generated a 53% reduction in headcount and 15 million a year annual cost saving. We have 38,000 colleagues working in low cost processing centres. The key is for us to fully leverage that by implementing standard activities and procedures, leveraging best practices across the Group and driving greater straight-through processing. For example, we have started implementing reduction of paperwork initiatives across the Group which will generate US$100 million by 2013. There's still an opportunity for us to shift professional and processing resources to low cost locations. Current migration plans will generate US$175 million a year in savings, and our procurement executives around the Group have detailed plans to drive US$300 million a year in annual cost savings by 2013.

Last but not least, Stuart mentioned the need to streamline information technology where we spend in excess of US$5 billion a year. We have done some benchmarking; it does show that our IT operational areas are highly efficient and effective but we need to improve our IT Development 'Change the Bank' area.

Frankly, our One HSBC programme was too IT centred and has not delivered the full suite of benefits that we envisioned. Now there have been successful elements of One HSBC; we have built a world class IT infrastructure around the world by consolidating 24 data centres across the last few years and we've come out with some great product propositions such as Premier Global View. But the fact is, we have room to improve.

We do need to reduce regional and local IT spend. We need to be open minded with respect to building less in-house, buying more. And there's an opportunity – a clear opportunity – for us to shift more IT resources to lower cost locations; and current plans will generate US$175 million a year by 2013. Yes, there's still an opportunity to consolidate data centres and streamline going forward.

So in summary, we will improve our organisational effectiveness and our cost efficiency ratio, primarily by delivering sustainable saves, enabled by the four key programmes that we're talking about and they'll be governed every month from the top of the bank.

During the rest of the day, my colleagues in the regions and the global businesses will give you more specific tangible examples of these things that we are doing collectively to make this happen. So let me hand it back to Iain for wrap up.

[Iain Mackay]

Thanks Sean.

So to wrap up on financial targets…

With respect to capital strength, we're well positioned to adapt to some of the challenges in the changing regulatory regime. We're absolutely committed to sticking to the target dividend payout ratio of 40-60% that we referenced at the end of the year.

As it relates to returns, and what we're targeting in this new regulatory environment, 12-15% is the challenge ahead of us and hopefully we've laid out here that this is not a slam dunk by any stretch of the imagination. There are clear challenges here, but the commitment of the team being able to achieve these targets will be clear and become clearer as the day goes on.

We're certainly clear that to be able to drive this operationally, we need to be able to be focused in and achieve 1.8-2.6% return on risk weighted assets across the businesses. There are clear defined actions, some are already implemented, others underway, including a framework for evaluating the shape of the group, assessing and re-assessing capital allocation decisions.

So, as we move through the day, you'll certainly see much of what we've talked about over the course of the last hour or so reflected in our business presentations in terms of the way we address these challenges.

As it relates to cost, we've been clear in terms of what we need to achieve and we've been clear about the disciplines that we'll deploy in executing against that target over the course of the next two to three years.

So in short, I think we've laid out, here, four areas where there are key performance indicators that you'll be able to monitor our progress on a quarterly and annual basis…the capital strength of the Group; the return on equity; the return on risk weighted assets; and the cost efficiency ratio.

The commitment of the team to achieve these is clear and confirmed and hopefully will become clearer as the day goes on. So with that, thanks indeed and I'll hand it back to Stuart to host the first Q&A session.

HSBC 2011 Investor Day

Overview

Questions & Answers

11 May 2011

Stuart Gulliver, Group CEO

Okay, we have actually quite a chunk of time for questions, although we should bear in mind that some of the questions may actually be picked up in the presentations that obviously will take place later on today. We also have a number of questions coming in from people on the webcast, so if I can just start with any questions from the floor here on this first set of presentations, setting out the overview of our strategic intent.

Tom Rayner, Exane BNP Paribas

Hello, it's Tom Rayner from Exane BNP Paribas. Can I just ask a couple of questions please; the first on why there's so much focus on setting a cost income target and delivering positive jaws, because clearly you can still boost your return on equity by investing in high cost income areas. You can also boost profit growth by running flat or negative jaws; I'm just wondering why the cost efficiency is seen as important maybe as the RoE targets. I have second question just on the data cleansing.

Stuart Gulliver, Group CEO

We need to – in a firm of 296,000 people, we need to come out with some fairly clear and fairly simple levers to direct behaviour and frankly focusing on a cost efficiency ratio where I think we'd all accept the fact that it's drifted outside the top of our range, we actually – as you can see from the wobbly bridge slide that Iain put out, we've added 3 billion of costs over the last couple of years with absolutely no revenue to show against it. We need – and we actually all recognise that we have inefficiencies within multiple Head Offices, multiple layers of management that may not add a huge amount of value, an IT area that in the software development side is not best in class, but there are actually clear areas that we need to drive through there.

What I would actually say to you is that the five filters approach should still enable us to invest in areas and businesses that may have high cost efficiency ratios. The private bank, for example, does run with a cost efficiency ratio of 70 vs. 66 best in class. This doesn't stop us investing in that, okay, but this is a Group average that we're looking at. Within it, it'll be made up of some businesses that have actually cost efficiency ratios lower than the number and some, as I say like Chris's, that absolutely are priority targets, but the five filters takes care of that. That's kind of why we've got that.

Tom Rayner, Exane BNP Paribas

Okay, thanks. Just the second – just on the data cleansing that Iain mentioned and the benefit that that has on the risk weighted asset calculation, could you just comment on the sort of view being put forward by people like Jamie Dimon that European banks may be somehow cheating – that might be the wrong word but certainly massaging the way they calculate PDs etc and their modelling and bringing down the risk weighting unfairly compared to what some of the US banks are doing. Could you give the HSBC view on that?

Stuart Gulliver, Group CEO

I think Douglas should have a go at that one. It's a Chairman type of question.

Douglas Flint

Thanks a lot.

Stuart Gulliver, Group CEO

And he was in a roundtable with Jamie just recently.

Douglas Flint

He was very vigorous in his views. I mean, I think that there's no question that one of the comments that have been made in a lot of analysts' research has been that the ability of banks to produce their own models and the advanced approach does lead to a great deal of flexibility and, of course, seen from outside, it's not clear whether in fact the metrics that have been put into the models that have driven a very low probability of default, and therefore loss given default and therefore capital weighting, is not transparent to anybody outside whether the model is as good as it could be and therefore the capital weighting is right; all we can see is the result. Now, I don't think – we look at the same kind of spread of ratios and it either means that people have got tremendous mitigants or very accurate models or a whole bunch of other arrangements that enable them to persuade themselves and their regulators – and different regulators take different views as to what the admissibility of a back testing period needs to be and so on, there are variabilities. I don't think anybody from outside knows whether in fact that people just have invested in the technology to deliver confidence in their outcome planning or whether in fact they've managed to have a set of modelled assumptions that are maybe optimistic. I think Basel III will remove some of the flexibility that some people fear but it's a bit of an assumption coming from those that are not yet on Basel II, never mind Basel III. Do you want to add Marc?

Marc Moses, Group Chief Risk Officer, Group Chief Risk Officer

I think it's rather a simplistic statement to make. I think one has to really look at the composition of one's portfolio in looking at the output and I think different banks have different portfolios and that can give a very different view. It's something that we looked into after Jamie did make that statement and it's more complex than just data cleansing and producing PD.

Iain Mackay, Group Chief Financial Officer

I mean one of the comments he made, which of course is a cracking one, is that if you look at risk weighted assets as a percentage of balance sheet fittings, the US firms have a much higher proportion but of course in Europe, we gross up all our derivatives, so you strip out for that and we have very different netting rules, so if you adjust for netting derivatives, you begin to get things that don't look that far apart but it's a powerful optical statement. I don't think you can tell.

Stuart Gulliver, Group CEO

Ian first and then Simon Samuels.

Ian Smillie, RBS

Thank you. Ian Smillie from RBS. Two lines of questions please. The first one on Mainland China Stuart, if you could comment on your thinking on the stakes in Bank of Communications and Ping An. How do you think that might play out in the medium to long term, whether you think there might be a possibility of increasing the stake in BoCom at some stage and, related to that, where you're up to in your thinking of potentially listing in Shanghai?

And the second question, more a point of detail, should we be expecting a restructuring charge to be taken at some stage by the Group in order to capture the cost opportunity or will that be leaked through the P&L between now and 2013, or how should we think about that?

Stuart Gulliver, Group CEO

I'll let Iain talk about the second but we hopefully wouldn't leak it through the P&L and not suffer under performance for a continuous basis, so yes, there will be some form of restructuring charge and I'll have Iain talk about that. Bank of Communications and Ping An remain the core stakes we have in China. The extent to which we could increase our stake in the Bank of Communications is clearly constrained by the regulatory environment there but we continue to work very, very closely with them and there continue to be fresh business initiatives. Both Douglas and I have met in the last month with the Chairman and President of BoCom, Peter meets regularly with them, Helen, who's based in Shanghai has regular business dealings with them so the extent to which we could increase our stake really depends on the regulatory environment, but as I say, we want to remain very invested in China and the best way to represent a significant capital commitment to China at the moment, remains – is at this moment in time, through those equity stakes and until that changes, it's not really a topic that's worth commenting on.

The Shanghai listing again, is something that we've been very, very public about our desire to be one of the first – well actually, hopefully the first foreign financial institution to be listed on the Shanghai Stock Exchange and we ourselves have completed and continue to work on a work stream to be able to deliver our side in terms of reporting, in terms of having prospectuses put together and put on wire and so on and so forth, but again, the ultimate decision and the ultimate timetable, is defined by the Chinese Government and it's very hard to interpret the smoke signals as it were as to the likely timing of that event. From time to time, one gets encouraged by thinking it may be this year, on other occasions, one gets the sense it might be a little bit longer but to be crystal clear, if we were given the green light to go, we will list on the Shanghai Stock Exchange, so that remains a priority for us but the timetable is set by the Chinese Government and what we are working on is to make sure that this is something that Ralph Barber, our Company Secretary, and indeed Helen Wong have spent a chunk of time on. So it really is going to be set by the Chinese Government but remains a priority.

Restructuring charge – Iain, do you want to do that?

Iain Mackay, Group Chief Financial Officer

Restructuring. I read your earlier piece and I was amazed by the number you came up with but we can chat about that later perhaps. Look, certainly what you saw coming through in the first quarter is work that Emilson and the team has undertaken in Latin America to do some restructuring around the region and as I'm sure you understand, what we can do from accounting rules' perspective, it's quite clear and quite rigorous. Certainly as and when the projects that we execute represent the requirement to take restructuring charges, then we'll clearly do so but the focus of the team is certainly getting our arms around the vast majority of a very substantial pipeline of projects that the teams are executing against, to identify those which represent any restructuring requirement. Some do, the vast majority don't because they're focused on re-engineering, streamlining and in many instances, the projects will give a yield without a need for restructuring but as we pull the data of that which does require a charge together, we'll be clear about the extent of those charges in our quarterly financials.

Simon Samuels, Barclays Capital

Good morning, it's Simon Samuels from Barclays Capital. I just want to ask on slides 46 and 47 where you wrote down your target return on risk weighted assets by business line and by geography, it's kind of relatively fresh disclosure, some of the RWAs on that basis. Can you give some sense about how those target returns compare to some kind of history for those – I guess mainly the geography makes more sense rather than the business line. I mean, I've just no real sense of whether that's the sort of above historic norms or in line with or actually less ambitious in this case.

Stuart Gulliver, Group CEO

They're reasonably ambitious targets actually. I mean clearly over the last four or five years, they all represent stretches, with the exception of Asia Pacific actually which has been hitting the kind of middle range but the other geographies and for the Customer Groups, these represent stretches in the kind of post 2006 world. I haven't looked at the data prior to that but there may well be some instances where Latin America, or the Middle East delivered higher numbers but again, it would be in a sufficiently different world, given capital requirements etc, that those points in time are really not going to be relevant for trying to get some sense of where the firm can deliver.

Simon Samuels, Barclays Capital

So just as a follow up, can you get any sense if you were hypothetically to dispose of your US credit card business, whether that sort of target in North America would be meaning to be different, so trying to get some sort of sense of what sort of return or risk asset would be the cards business in North America?

Stuart Gulliver, Group CEO

The cards business, and perhaps Niall might want to add a comment or two, but the cards business in North America is actually a profitable business, it's just non-strategic, so initially, a disposal of the cards business would be dilutive at Group level but, as I say, what we need to be, I think, is disciplined about the things we own, rather than trying to be all things to all people and it really does depend on whether hypothetically we do manage to get anyone who's actually prepared to pay a sensible price for it, but the cards business in North America actually has really actually been incredibly well managed. In fact, Pat Burke who has been managing it actually is in the room; it is a good business, has offered great returns, but is not strategic to the Group and again, I think we've got to be disciplined about that but basically, North America, absent the card business with sub-prime still running down, will look worse than that. The target RoRWA assumes that we move towards, and this is rather stealing some of Niall's thunder from his presentation, but moves towards an environment where perhaps we've looked at the cards business, perhaps we've looked at some of the branches, we've got Global Banking and Markets performing and we've re-structured to get a Commercial Banking business performing. So, again, the target RoRWA of North America is a kind of end-state target but, as I say, it's not a straight line because, as I say, the cards business is actually been a very high return but completely non-strategic business.

Arturo de Frias, Evolution

Thank you very much. Arturo de Frias, from Evolution. Two questions again on those two pages because they are probably some of the most interesting new numbers that we have today, 46 and 47. The target RoRWA as you just mentioned for Asia, the range 3.4 – 4.2 and Asia is already at 3.8, so basically that doesn't seem to be a division where you expect substantial improvement, which to some extent surprises me because with interest rates going up and the very substantial impact that that will have in margins, I would have expected some improvement in profitability, so is the underlying message that you expect all the improvement in revenues to be spent in keeping talent? That's one. And then the second one is on the following page on GBM. GBM's RoRWA is going to fall from where it is now, which I think is absolutely realistic. GBM is going to become the lowest profitability business in the Group, substantially when you compare it to GP or CBM etc. Does this imply that we should expect GMB to be reduced or downsized at least in relative terms versus the other divisions going forward?

Stuart Gulliver, Group CEO

Okay, let me first take the Asian question. The Asian business is a superb business and I think we should actually celebrate the fact that it has a 3.8% return on risk weighted assets. It is facing inflationary pressure, you're absolutely right. However, the extent to which interest rates go back up in Asia really depends on which interest rates go back up because the very big deposit base is in Hong Kong in Hong Kong dollars, so the fact that the Indian Rupee rates have gone up and Malaysia may have raised its rates, has some effect on balance sheet management but quite negligible, we don't have that big a balance sheet there. The real drive is Hong Kong dollars. The Hong Kong dollar is pegged to the US dollar, so monetary policy in Hong Kong is basically set by the US FED so actually we don't see what you've just described coming through, so therefore, this really reflects the inflationary pressure that actually we face in terms of retaining staff.

For Global Banking and Markets, no; the intention is to continue to look to drive 30-40% of the Group's PBT from Global Banking and Markets. These are obviously a Basel III world return on risk weighted assets, we think the Global Banking and Markets product suite is essential to deliver both the Commercial Banking number and also the Private Banking number as well as being incredibly relevant also to the delivery of the Wealth Management strategy. Don't forget Global Banking and Markets is a customer group, Global Banking, and a product group, Global Markets. The Global Markets aspect of it serves not just the Global Banking client base but also the commercial bank, the private bank and the retail bank and therefore, it kind of sits at the centre of that and the margins that would be made in dealing with those customer groups, sit in the return on risk weighted assets of the commercial bank, private bank etc, so in a way, this kind of understates a little bit – actually it understates quite a lot, the contribution from Global Markets, but there is – to be crystal clear, there is no intention therefore to change the rough percentage contribution we would want from Global Banking and Markets. It will still – you know, ideally through the cycle make, you know, 30-40% of the Group's PBT.

I think we'll just systematically just work backwards if we can on this side and then come through this lot.

Christopher Wheeler, Mediobanca

Could I ask a question on your M&A strategy? I think you've sort of been suggesting this is very much an organic strategy to get to your targets and you made a pointed comment about the organic growth for Commercial Banking and global investment banking. But are we just looking at a situation whereby literally there is going to be a disposal story for the foreseeable future as we go through this retail strategy. But what would change your mind and make anything change in terms of looking at something would be very interesting.

Stuart Gulliver, Group CEO

I wouldn't want you to get the conclusion that it's just a disposal strategy but I think the key points that I would want to make is clearly there will be some disposals as we apply the filters but we are not in a position today as I say, to put out a laundry list. The second thing is we're actually pretty good at growing organic businesses, so the extent to which we generate capital, there's quite a strong argument for us actually simply reinvesting that capital ourselves in the organic growth of our own businesses, but I absolutely would – I'm not trying to rule out or send out any signalling that M&A is something that we would not look at. It's absolutely going to depend on an opportunity as it arises and the classic thing, as this is going to get really repetitive, so I apologise in advance, it will have to hit the five filters, so if there is something – and so what kind of thing might do that? Well, it will generally be in country, in a country that fits the likely growth criterion we set out, a country that connects to the rest of our Group and where we can see in pretty short order, actually probably within two to three years of closing the acquisition, that we can get to those financial criteria, so you get a return on marginal invested capital of 12-15%, the cost efficiency ratio is settling towards the Group one, unless it's a business like a private banking business, and that it hits to some extent our funding criterion etc, so I'm not ruling it out, but I don't – what I really want to make quite clear is, there is an absolute route to improving the performance of HSBC without doing any acquisitions and that's what we're trying to make quite clear here. What I'm not trying to say by that is, our minds are closed etc, but this is not – this is absolutely within the gift of the team here to deliver on all of those without making an acquisition to apparently make it easier to do so.

If we can go row by row, rather than me picking at random and then we'll take one from the call after this.

Jon Kirk, Redburn Partners

It's Jon Kirk at Redburn Partners. Could you talk a little bit about revenues please, you haven't done much on that this morning and maybe there's more to come this afternoon, but I'm particularly interested in your view of revenues going forward in light of some of the costs that you are going to be saving and how that might interact with the revenues? And secondly, a bit more detailed question. You talked, or rather at least some of your cost savings relate to standardisation of things like IT and business models etc. How realistic is the role model, how achievable is that, I guess given the idiosyncrasies of all the different markets that you operate in, how far can you go with that standardisation?

Stuart Gulliver, Group CEO

I think the revenue question is best answered once we've been through the geographic and Customer Groups, otherwise we're effectively running into the territory, where I'm delivering every single presentation, which is clearly not in anybody's interest. It's all about target operating models and that's why, now with Alan Keir as a Group Managing Director representing Commercial Banking, we put Alan onto the Group Managing Board in January, so there's a single person there responsible for Commercial Banking globally, there's a single person responsible for Retail Banking and Wealth globally, which is Paul Thurston, they can define the target operating model and they now have the authority if you like, to implement that across the geographies. The beauty of a geographic structure is obviously it helps you fit to legal entity, asset liability, committees, balance sheets, regulators etc, but of course, it does create this incredible variety of different business models which then massively increases the complexity of your IT requirements and makes it a huge challenge for your programmers to come up with any kind of operational efficiency and scale advantage from programming. So I'm actually reasonably confident we can do this because I think we have also entered the kind of new era and the geographic Management are all here as well and members of the Group Management Board, and actually I think we do have a cohesive group of people, so I am actually confident that we can do this. It will take, though, some time. I mean that's an important – we unfortunately live in a world where it would be nice if we could do all this by lunchtime and actually I'd quite like to have done all this by lunchtime but it's going to take a couple of years to do it. But I'm confident we can do it and we've been very, very careful, clearly, in setting some of the stuff out to make sure that we have set out things that we believe are achievable.

Robert Law, Nomura

Could I have a couple of questions please? Firstly on the cost issue, I'd like to follow on the previous question and explore the achievability of them. If I look at the first quarter's numbers and I'm cautious of extrapolating the first quarter but it's usually the best quarter in terms of cost/income ratio. To get down to the ratio that you're targeting, I think you'd need bigger cost saves than even the $3.5 billion maximum range you're setting here, so can I ask, are you targeting the individual business units to achieve positive leverage in addition to those savings and are there business units that you would point out as being particularly high in terms of efficiency ratios at this point that you'd like to see come down, because what we see in the presentation so far is taking out of expense out of the centre and the operational rather than the individual business units, that's the first area.

Stuart Gulliver, Group CEO

Okay, well Robert, you'll see more evidence of individual cost saves as the geographies and businesses present, so you'll get better insight into examples and anecdotal examples of where we can restructure as the day goes on. I mean we've focused here at the beginning clearly on things that were in the first quarter and fit within kind of the Head Office piece.

We do think that these cost savings, these sustainable cost savings and this re-engineering is achievable and we actually do believe we can drive the cost efficiency ratio towards – directionally down from where we've been sitting and we've made it quite clear that it will take us until 2013 to get it to the top end of the 48-52 range, so that in itself reflects some of the caution and concern that you have about the size and scale of the challenge, but I don't think it's something that's impossible to achieve at all, otherwise we wouldn't be standing collectively up with it.

Robert Law, Nomura

The second area is on the GBM business because if you take the balance sheet management revenues out of GBM, which I would argue really ought to be allocated to the other business units that generate the surplus liquidity that that money is earned off; if you take last year about $4 billion out of the GBM number, getting it down about 5.5 and if you then start imputing the Basel III changes onto the GBM business, you could get down to pre-tax return on risk weighted assets on a Basel III basis of about 1%. Now that's similar to what other capital markets firms are; it's no different from the pressures that other capital market firms face but I wonder what your thoughts are about that arithmetic and how you would improve it towards the kind of 2% numbers you've got here.

Stuart Gulliver, Group CEO

Where we allocate balance sheet management I think is a sort of debate point. What we wouldn't want to do is to have significant liquidity and interest rate risk run within Commercial Banking or Personal Financial Services. There's a skill set expertise that exists in Global Banking and Markets and it's very, very disciplined in transfer pricing so there's absolutely no margin in Global Banking and Markets from this activity. The BSM P&L is entirely gapping P&L; it's entirely therefore interest rate risk. We've debated internally whether or not the generators of the deposits or the generators of the assets should have effectively the gapping P&L that's being made by reading the market correctly which is quite different from the volume P&L of raising the deposits where they do actually capture the margin because it's transfer price across into balance sheet management, so do not think for a second BSM contains any of the P&L of Commercial Banking or Retail Banking and Wealth Management. It doesn't.

For the general return on risk weighted assets of our global markets and global banking business, I think the piece you're probably not giving enough allowance to is the extent to which we don't have such a huge structured derivative book as a Barcap or a Deutsche, so therefore the jump in Basel 2.5 is less and less pronounced for us – or a JP Morgan for that matter. We did not – we've always had a traded liquid model, traded liquid markets model with a huge focus on emerging markets and that has less of a RWA impact than happens to some of our competitors but we're also building out some fresh revenue strings and Samir will talk about this but the first quarter of this year – and this will bring a wry smile from a number of you since you're all in the equity business – we had the best quarter we've ever had in equities in terms of revenues. The Hong Kong market is the largest IPO market in 2010. We're building out our – and continue to invest in our custody business and in prime services, so we think there's a big opportunity in the transaction banking part of Global Banking and Markets, we think there's a big opportunity from the growth trends that we've set out and we think there's a big opportunity, as I said, if you reverse the comment I made earlier, the global markets effectively is a product group that's servicing all the other customer groups and they will grow because of the trends I've set out. Actually we think we can get to these numbers. I absolutely hear what you're saying but we're not running a wholesale banking business that's European-centric and that made all of its money in structured derivatives. It's not that shape of business so therefore I think it can produce higher returns, but Samir will go into some detail on this under the Global Banking and Markets.

I need to take one off the call if I may. We have Sunil Garg queued. So if we can get the technology to work.

Sunil Garg, JP Morgan

Thank you. Stuart, I have two questions, the first on connectivity. Your predecessor talked a lot about a joined-up bank so I think it would be useful to understand how this is different if at all in terms of strategic direction.

The second is going back to your comment on the 1.8-2.6% pre-tax RoRWA being a stretch target. You made 1.7% pre-tax RoRWA last year and, if I calculate correctly, your underlying pre-tax RoRWA in the first quarter was 1.95%, accounting for Basel III RWA impact. I mean, aren't you already there at a cyclical low level, so is this really a stretch target?

Stuart Gulliver, Group CEO

I'll let Iain take the second question on return on risk weighted assets after I've answered the first. This gives you a suitable amount of time. Now the connectively – actually, they describe two totally different things and I'm not going to criticise anything that Mike Geoghegan did. He was running the bank during a very, very difficult time during the worst financial crisis since the 1930s, but we're referring to different things. Mike was talking about connecting up the firm, so he was talking about whether we could get onto a single IT platform; it was a kind of engineering solution. The connectivity I'm describing is two things. The connection between the emerging markets and the developed world, it's the original slides at the start of my presentation. The connectivity I'm describing is a world that is not going to go back into isolated protectionism where capital is going to have to flow from the surplus countries to the deficit countries, where global trade will continue to develop, where actually the wealth creation of the world will move from the developed world to the emerging markets, so my point about connectivity is a global macro trend, not an internal description about an IT strategy, okay, so although the word is unfortunately the same, it describes something completely different.

And then the second point, remember, that I was making is, that connectivity it a very big opportunity and the way we take advantage of it is through our network and it's that network in those large number of countries that enables us to reap the benefits of that growing macro connectivity trend, so it's the slides at the beginning of mine, it's kind of 14 onwards, which make – actually it's not 14 onwards, it's 12 onwards – which is what I'm describing by connectivity, so same word but completely different meaning. And then whether our return on risk weighted asset target is too easy, Iain.

Iain Mackay, Group Chief Financial Officer

Certainly based on the amount of time invested in trying to model this one through, I'd say probably not. Return on risk weighted assets on a Basel II basis at the end of the first quarter, for the first quarter, was 1.8% on Basel II basis so when you then flow through this somewhat consequential effect, certainly on Global Banking and Markets returns, of Basel 2.5 and Basel III, I think that creates some interesting challenges around being able to achieve the lower end of the target in the short term. I certainly think that once you get the opportunity to sit down and sort of flow this through your models, which I'm sure everybody will be doing later on today, I think you'll find when you track back to your own models that this actually represents a fairly significant challenge in terms of both return on risk weighted assets and the translation on a Group basis back to 12-15%.

Sunil Garg, JP Morgan

Iain, sorry, just to – not to labour the point but on slide 4 of your presentation, the RWA impact is laid out as 100-115 basis points, so on a [inaudible] basis, that gets you from 170 basis points in Basel II to about 150 basis points in Basel III RWA. And then you had a $5 billion annual run rate drop in your loan loss provision from 2010 to the first quarter which on the new RWA adds 40 basis points, so that's the calculation I'm referring to.

Iain Mackay, Group Chief Financial Officer

Okay, fair enough. I still think if you model this through, you're going to find it very difficult – when you think about the composition of where we stand today with some of the run-off books that we're dealing with, within North American business, which as you quite rightly point out, Sunil, represents a fairly significant drag for us, as well as the impact of the legacy books within the Global Banking and Markets, running those off over this period of time will certainly provide some uplift. I wouldn't necessarily suggest a complete read through in terms of a run rate drop and loan impairment charges for North America directly and then extrapolate it.

Sunil Garg, JP Morgan

Okay, thanks Iain, thanks Stuart.

Stuart Gulliver, Group CEO

Thanks Sunil. Okay, we have time for one more question and then we're going to break for coffee.

Huw van Steenis, Morgan Stanley

It's Huw van Steenis from Morgan Stanley. One thing which was troubling me. You obviously are selling us your story today as an Asian growth story. When I look at page 46, as I run through it, it seems like the vast majority of the improvement is actually coming from cost cutting in North America, provision improvement and obviously a load of improvement in Europe and Latin America. If I go to page 46 and take the middle point, your target return on RWA, it strikes me there's about a 5.5 billion improvement of which two thirds comes from normalisation of provisions in the States, plus cost cutting. Could you maybe just help us then, think three years out, how much of your targets are really going to come from provisional improvement, cost cutting and revenue growth? Because certainly as it's laid out today, it seems to be quite light on revenues and a lot more on below the line numbers.

Stuart Gulliver, Group CEO

That's a fair comment but actually, if you think about it, we've had a massive Asian revenue growth story for about the last three or four years and got no real value for it because of all of the problems that have weighed down the Asian revenue growth story, so the Asian revenue growth story is still intact. What we've got to do is remove, if you like, the sea anchors that have been slowing that down and that is what the focus is upon but I wouldn't interpret that as meaning there's no revenue growth. There clearly will be revenue growth but the thing that's slowing the Asian revenue growth story, and you've seen it again in the numbers that we gave this time – look at rest of Asia Pacific, Hong Kong and again move to the other emerging markets, Latin America – the emerging market piece of HSBC has performed extremely well. The drag has been the things that we are now re-engineering. That in a way should liberate the Asian growth story from within the share price, quite honestly. So I don't think it's wise at this point in time to say *x%* will be costs and *y%* will be IT restructuring and with that level of precision but actually, what you've described is in fact the reverse of how I see it. What I see is a fantastic Asian growth story that's been going on for – actually throughout the booming part of Asia that's been weighed down by some of the initiatives that we took in other parts of the world and some of the inefficiencies that we've allowed to build them in our firm that we're now going to tackle head on.

We now need to take a coffee break and refreshments will be served at level 40. There will be people outside that will show you to that area and then we will then re-start again in 15 minutes' time. So therefore, we'll start at 11.20 with the first of the global businesses presentations. Thank you.