Thomson StreetEvents℠

Conference Call Transcript

HBC: HSBC Holdings plc
2008 Interim Results

Event Date/Time: Aug. 04. 2008 / 6:00AM ET

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CORPORATE PARTICIPANTS

Stephen Green
HSBC Holdings plc - Group Chairman

Michael Geoghegan
HSBC Holdings plc - Group Chief Executive

Douglas Flint
HSBC Holdings plc - Group Finance Director

Vincent Cheng
The Hongkong and Shanghai Corporation Limited, Chairman

Sandy Flockhart
The Hongkong and Shanghai Corporation Limited, CEO

Stuart Gulliver
HSBC Holdings plc – Global Banking and Markets, CEO

CONFERENCE CALL PARTICIPANTS

Alistair Scarff
Merrill Lynch Hong Kong - Analyst

Tom Rayner
Citigroup - Analyst

Arturo de Frias
Dresdner Kleinwort - Analyst

Cameron Odgers
CICC - Analyst

Tim Sykes
Execution - Analyst

John Wadley
UBS - Analyst

Simon Samuels
Citigroup - Analyst

Nick Lord
Macquarie - Analyst

Robert Law
Lehman Brothers - Analyst

Ian Smillie
ABN Amro - Analyst

Bill Stacey
Aviate Global - Analyst

Alistair Ryan
UBS - Analyst

Chi Cheng
Eton Park - Analyst

Michael Helsby
Morgan Stanley - Analyst

Sandy Chen
Panmure Gordon - Analyst

Leigh Goodwin
Fox-Pitt Kelton - Analyst

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PRESENTATION

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Good morning to our guests joining us from Hong Kong. I'd also like to welcome those of you who are joining us via webcast or conference call.

Let me start with a few introductions. In Hong Kong we have our Executive Director, Vincent Cheng, Chairman of The Hongkong and Shanghai Banking Corporation, Sandy Flockhart, Chief Executive. Also in Hong Kong are Edgar Ancona, the Chief Financial Officer for Asia, and Russell Picot, HSBC's Group Chief Accounting Officer.

Alongside me here in London, our other Executive Directors, Mike Geoghegan, our Group Chief Executive, Douglas Flint, Group Finance Director, and Stuart Gulliver, Chief Executive of Global Banking and Markets. And I'm delighted to announce that in the front row we have two of one non-executive Directors, Sir Brian Williamson and Sir Mark Moody-Stuart. Thank you for joining us.

Before we start, the usual cautionary words on forward-looking statements are on the screen in front of you. And I'll move to the headlines of our reported results. Profit of $10.2b before tax, down 28% or down 22% after the dilution gains that you will recall inflated last year's first half. Attributable profits $7.7b, down 29% or down 22% on that same basis. Earnings per share $0.65, down 32%, or down 24% ex the dilution gains. And return on total shareholders' equity of 12.1% as compared with 19.1% last year. Dividends per share in respect of the first half was disclosed in the 2007 annual report and accounts, up 6% at $0.36. And our Tier 1 Capital, 8.8% as against 8.7% at the end of last year. And our core equity Tier 1 ratio of 7.5%, which is in fact unchanged on the end of last year.

When I look at this performance, I start by the way by saying that we put out more information, more disclosure on our market positions in relation to the financial markets turmoil than ever before. And I hope that we will succeed in conveying to you that we're a very conservatively positioned bank in respect of the market's turmoil. Overall my take is that this is a resilient performance in what are the most difficult markets for several decades. The balance of earnings between markets and businesses helped cushion us from some of the impact of the market turmoil. We're profitable in all of our Customer Groups, including Global Banking and Markets. And profitable across all of our geographies, with the continuing exception of the U.Ss and the business difficulties that we're working our way through there.

There is the unwavering HSBC commitment to financial strength shown in those capital ratios. And we've continued our dividend policy and our commitment to make capital available for future investment. One other feature of these results, the costs are I think very well controlled. And all of the above has produced the result that we are in the top five or so of our competitor peer group in terms of benchmark performance.

Let me turn now to Douglas, who's going to take us through the financials in more detail. Douglas.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

Stephen, thank you. Stephen has given you an outline of our overall performance and of general market conditions. I would now like to highlight the key figures behind the performance in the first half of 2008. Our net operating income before loan impairment charges rose 3% to $39b. Operating expenses were 8% higher at just over $20b. And loan impairment charges are just over $10b, a rise of 58% meant that profit before tax was 28% lower than in the first half of 2007, at $10.2b.

Revenue performance was constrained by write-downs in Global Banking and Markets of $3.9b. And this was a major driver in the cost efficiency ratio easing out from 48.3% to 51%. This remained however within our target range of between 48% and 52% in part attributable to good cost performance in the developed markets.

Comparing our underlying performance against the first half of last year and the adjustments to underlying are, as in previous periods, currency legislation impacts, acquisitions and the dilution gains that we reported last year and on this basis our net operating income before loan impairment charges was up by 2%. It's worth noting that revenue growth was achieved after absorbing the $3.9b write-down in Global Banking and Markets. And as revenue generation elsewhere, indeed much of it in the rest of Global Banking and Markets was very strong, underlying growth and operating expenses was 4% which we believe compares well with the rate of global inflation. Mike will be illustrating how all this

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was achieved in his remarks. Clearly the most significant underlying change remains the 55% growth in loan impairment charges, to which I'll return later.

If we compare underlying performance against the second half of last year, you'll note that both income and costs are down modestly. Notably the loan impairment charge was 8% lower than the second half of last year and that was driven by the U.S. As a consequence pre-tax profits were broadly flat.

This slide draws together simply for ease of reference the special factors we have highlighted affecting the last three half-year performances. These items relate simply to the gains arising from dilution of our interest in our Chinese and other associates, fair value adjustments from credit spread movements on our own debt, market turmoil write-downs taken in Global Banking and Markets. And a new item in this period, a goodwill impairment charge in respect of our North American Personal Financial Services business. From my perspective, what this reveals is the underlying progress made against both halves of 2007. And in particular the second half of last year has been good.

This slide shows that risk weighted assets have been growing in line with loans and deposits. Now as you'll all be aware, under Basel II the risk weighted asset calculation has many, many moving parts. And so the risk weighted asset movement on this slide primarily reflects growth in commercial credit generally, growth in personal lending in emerging markets, higher market risk capital requirements because of market volatility, offset in part by a reduction from higher risk lending in the United States. And these risk weighted asset movements translate through to a Tier 1 ratio of 8.8% in line with that achieved at the end of 2007. The comparative figure for the end of 2007 has been restated from the pro forma basis we used in last year's accounts to an actual basis. And as Stephen says, our core equity Tier 1 ratio remains unchanged at 7.5%.

Now let's turn to retail credit quality. This slide shows that for Personal Banking outside of the U.S. we did better in Europe, driven by the U.K. And we saw some deterioration in Latin America, driven by Mexico. In Asia our loan impairment charges remain low. Finally in North America the impairment charges, which are clearly driven by the U.S., were $3.2b higher than in the first half of 2007, but $1.2b lower than the second half experience. And Mike will be taking you through the portfolio trends in the U.S. in more detail in his remarks.

In Commercial Banking, credit experience has again been broadly stable with Asia standing out as remarkably low, which reflects the buoyant economic conditions. We expect developed markets to progressively incur higher credit charges as economic slowdown impacts spending patterns.

Turning to Global Banking and Markets. This slide summarizes the source of the write-downs. There are five important points I would make.

Firstly, the liquid trading positions have remained materially unchanged since the end of last year and thus the write-downs reflect falling valuations of existing positions, and not new risk.

Secondly, as regards asset backed securities, which are the first and second lines on the slide, valuations reflect on a security by security basis underlying asset quality, origination vintage and the extent of over-collateralization as well as significant discounts for market illiquidity. Where we can benchmark our valuations we believe these lie at the conservative end of the market range.

Thirdly on leveraged loan exposure, i.e. the third line, the write-downs relate to illiquidity. The principal underlying corporate exposure is meeting the performance metrics that were forecast when the underwriting commitment was made. Indeed, had this loan, or had this exposure been categorized as a loan in our books we would not be raising an impairment provision.

Fourthly the additional write-downs of monoline exposure reflect a decline in the valuations of the underlying asset backed securities together with deterioration in the financial strength of certain monoline insurers. It's worth noting that of the remaining $1.3b net mark to market exposure, two monolines, over 90% is to insurers which are rated by Standard & Poors at Triple B or above. And finally to note we have no material exposure to CDOs on asset backed securities which are backed by U.S. sub-prime assets.

Having dealt comprehensively with asset-backed securities held within the trading books, I now want to address the position on asset based securities held as available for sale. And so mark to fair value through equity but subject to impairment testing.

You will see in the accounts that there is a deficit in the available for sale reserve of $7.3b at June 30 versus a surplus of $850m at the beginning of the year. Asset backed and mortgage backed securities held within Global Banking and Markets account for the overwhelming majority of the Group's fair value adjustment for AFS assets. And the total portfolio of such assets represents just under $70b of book value and that's some $10b lower than the position at the end of last year. Over 75% of this book value exposure is to prime retail mortgage backed securities, and

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commercial mortgage backed securities, to U.S. government agencies and to student loans. All of good asset quality, of good origination vintage, and well supported by over collateralization.

Roughly half of the remaining sub-prime and Alt A exposure is held through conduits which benefit from first loss protection from third parties. And thus the impairment on the slide of $134m, which has been recognized during the period, falls to their account, not to ours. There is remaining after this attribution of impairment a further $1.2b of loss protection available from this first loss protection to protect our profit and loss account.

And finally regarding the remaining directly held exposure. Well, fair value movement has been significant as credit spreads have widened. Actual impairment, that is, projected cash flow deficiency is actually very modest, but precipitates the reversal through the profit and loss account of the $55m cumulative fair value deficit which is in reserves.

Lastly on market risk metrics, three points to draw to your attention. Firstly, the increase in value at risk was mainly due to two factors. Positioning for the following interest rates in both U.S. dollar and Hong Kong dollar interest rates as well as increased market volatility during the period.

Secondly, to know that the daily distribution of global markets revenues was more dispersed than our normal pattern as a result of the market conditions which has impacted all market participants. And finally to note that the vast majority of our trading positions are valued with reference to quoted market prices or using observable inputs to valuation model. HSBC's exposure to valuation risk from illiquid and bespoke positions remain modest, with only 3% of our trading assets having to be valued with reference to significant and unobservable price input.

Let me now pass you over to Mike.

Michael Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

Thank you, Douglas. Stephen highlighted the challenges in our industry. And obviously at HSBC we are impacted as well. However, the Group Management Board of HSBC has more global experience than most teams in banking today. In fact collectively it has over 300 years of experience. And many have seen two or more past banking crises across the world in their lives, which positions them well for this current one. It is this team that has been implementing our strategy of moving our profit before tax towards a 60% contribution from emerging markets whilst re-engineering our businesses in developed markets through 'Joining Up the Company'.

Let me now outline our progress. In March 2008 we advised you of the key metrics that we are using to measure the company and ourselves over the cycle. In this, the first half of 2008, we have impressively met our measures except in the area of return on shareholders' equity, which although not meeting the range was a credible 12.1% in particularly difficult times.

Turning to our geographical spread of business, and taking out last year's dilution gains, we have seen very pleasing growth in Asia, including the Middle East, Latin America, and surprisingly strong results in Europe, particularly in the U.K. The weakness has been in the United States, both in regard to Personal Financial Services and Global Banking and Markets. However despite the USA, we were profitable in all our business segments.

Now let me drill down and take the regions first.

In Asia we had profits of $6.7b, which are certainly impressive. But at first glance the business looks flat. But there is a reason for that. In the first half of 2007 you will remember we benefited from our one-off dilution gains. And we highlighted this at the time. When this is excluded profits are up 20% year-on-year.

Year-on-year in Hong Kong profits are down 8%, and down 23% (inaudible) comparing it with the first half of -- the second half of 2007. This is partly due to us having to write down some of our strategic investments in Vietnam and India as their stock markets have fallen. Without these write-downs the results would have been flat.

However these investments are long-term financial stakes in two very important emerging markets and we're very happy to have them. Commercial Banking in Hong Kong had a record performance. And deposit growth was up overall 11%. What is clear is how exceptional 2007 results were. Results are still strong but with a falling stock market there is less revenue opportunity in our Wealth Management and Private

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Banking businesses. And lower U.S. interest rates are constraining deposit spread. Hong Kong remains an extraordinarily robust business but it is contrary to some people's views not totally decoupled from what is going on in the rest of the world.

The other side of the coin is the rest of Asia, excluding the Middle East, where the profits are up 58% year-on-year, and 34% against the second half.

Global Banking and Markets have an exceptional performance with profits up 75% to $1.5b. That is clearly demonstrating that our 'Emerging markets-led and financing-focused' strategy is working.

Looking at Asia by country, double digit profit before tax can be seen almost anywhere. You can see we have better than 40% growth in Australia, China, Malaysia, South Korea and Taiwan. China, excluding dilution gains in the first half of last year, was up 92% which means progress just isn't being made through our Chinese associates. We grew our own China business by 85%. Because of our strong brand recognition in China and our ability to service Chinese corporates investing in trading out of China and international companies coming into China. In the Middle East where we made nearly $1b we were strong across all our customer groups, both on a year-on-year basis and on a trailing basis. To put this into perspective it was only two years ago that I stood here and I was saying we made $1b in one year. This business is now a major contributor to the Group.

Profit grew in Latin America by 27% to $1.3b, and was spread across all our businesses there, particularly in Brazil. Global Banking and Markets had a strong gains in revenue and profit before tax from expanded product capabilities in the region, another example of 'Joining Up the Company'. In Europe we continued to re-engineer our businesses. In the U.K. since called the top of the market in late 2006 we have been strengthening our credit standards in our unsecured personal loans and card portfolios. Consequently we haven't yet experienced any real deterioration in credit quality in these portfolios.

On the mortgage side we purposely scaled back in 2007 when we felt pricing was unrealistic. We did stand into the market in April of this year when others couldn't, lending a total of $11b in the first half. This was a good example of us using our capital for organic growth as well as benefiting our customers who were switching their deposits to HSBC. We are monitoring the mortgage market carefully, focusing on quality house owners who are being let down by others. These new customers are not just moving their mortgages, but they're bringing their entire banking relationships to HSBC.

In France we completed the sale of our six regional subsidiaries and an exit multiple of 21 times earning. And the resultant profit will be reflected in our second half results. We are now focusing on rolling out Premier and Commercial Banking centers in Paris and other major cities.

Turning now to North America. The region continues to disappoint but we remain resolute in fixing our business there. We cautioned in late 2006 that we saw weakening consumer markets, and regrettably we haven't been proved wrong. The deteriorating U.S. economy continues to affect our Personal Financial Services business. However outstandings are down and two plus delinquencies appear to be stabilizing. I'll expand on that in a moment. The fallout from the market turmoil also impacted our Global Banking and Markets business in the United States, and I'll come back to that as well.

Turning to Personal Financial Services. It's a tale of two businesses. Profit before tax fell 51% to $2.3b, as U.S. loan impairment charges rose. But like Asia, there is a story underneath the headline. Excluding the U.S. Personal Financial Services business, profit before tax was up 33% to $4.5b with progress in both developed and emerging markets.

In emerging markets we are expanding our Asian branch network by over 60 branches in the first half of this year. We grew a strong balance sheet in the Middle East and we increased our share of Credit Cards in Mexico and raised our deposits in Brazil. HSBC Direct, our direct banking system, is ahead of expectations. We increased the customer base by 15% and grew total deposits to over $16b despite very stiff competition in the United States.

In the USA our Personal Financial Services business made a loss of $2.2b. Although delinquencies increased, they were broadly in line with expectation. Loan impairment charges were up 85% compared to the first half of 2007, but down by 15% compared to the second half. Our exposure continues to fall and our performance continues to improve. Costs overall were down 14% from the first half of 2007 and second two plus delinquencies appear to have leveled out for the last three quarters.

Looking at our mortgage business, if we take the Mortgage Services first, on the left-hand side of the screen where you will remember we said in March 2007 that this was a portfolio we intended to run off over three years. You can see that we reduced the portfolio by close to $5b, 13%. Around 60% of this was from repayments. Our outstandings in this portfolio have fallen around $5b per half year for the last three sets of results.

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The rate of deterioration, the two plus delinquencies has declined. And importantly the U.S. dollar level of two plus delinquencies has stabilized over the last three quarters.

On the right-hand side we show Consumer Mortgage Lending, originated through our branches. And the level of deterioration there has not yet stabilized. We continue to tighten credit standards and the portfolio size has leveled off. For both portfolios we are not calling the bottom of the market. We believe that we are benefiting however from our earlier recognition of the sub-prime problem. As volumes of new mortgages and personal unsecured loans have slowed further, we have trimmed back our branch network to 900 branches. And we continue to work to address customer problems. We have expanded modification and foreclosure programs. We continue to work with our customers in the most constructive way possible. The mortgage business is personal to me because we are talking about people's homes. We will always go the extra mile, and I'm proud of the way our colleagues have been truly caring for our customers.

In both our Credit Cards and Private Label businesses our dollar delinquencies have slowed which compares well against industry trends. And we have managed down our balances. The business is core to us, and we certainly hope that the current trends continue. But obviously the risk of unemployment is a concern. We increased collections in the unsecured personal credit market and lowered our balance sheet by about $1.7b from the comparable period last year. In Vehicle Finance the credit quality of the portfolio actually improved over the period. But it is not core to Group strategy, and does not have a critical mass. And so we have announced today that we will not originate further vehicle loans. We envisage running off the majority of the portfolio in the coming three years. From now on our consumer based finance business will focus mainly on cards and Consumer Lending through our branch network.

Turning to Commercial Banking. Commercial Banking continues to be resilient across the world, with a profit before tax of $4.6b, up by 35%. This number however includes a one-off gain of $425m from the sale of the U.K. card acquiring business to a joint venture with global payments. Excluding this underlying growth in the period, profits were up 22%. And 70% of that growth came from emerging markets, which now accounts for 50% -- 54% of the total Commercial Banking profits. Another example of our strategy working.

Growth was strong in the Middle East, Latin America and Asia-Pacific, particularly in China and India. We had a great half in Brazil with increased transactions, increased lending and increased foreign exchange. And loan impairment charges fell. The U.K. had a strong performance in a difficult market. Our signature financial strength here is attracting customer deposits, and we grew average lending balances by 13%. However, we have been watching lending standards as we expect continued turbulence as others, less capitalized banks, become unable to support their customers. We will be selective in this market.

Internationally we grew our small business customer base by 8% to 2.9m customers. We were especially strong in Turkey, Taiwan, China and India. We expanded our business direct online banking in the U.K. and Brazil and now have 150,000 businesses sign up to this product. We will launch in India and Northern Ireland in the second half of this year.

Now turning to Global Banking and Markets. Like Personal Financial Services there are two parts. On the one hand there were write-downs. On the other, our ‘Emerging markets-led and financing-focused’ strategy paid off. Emerging markets' profit before tax was up 51%. Global Banking and Markets now represent 26% of the Group's total profits. Foreign exchange reported record revenues off the back of greater market volatility and higher customer volumes across all regions. Customer activity in deal growth helped strong results in rates. And the Securities Services business continued to grow despite lower interest rates and lower equity markets as the flight to quality continued with more institutional customers choosing HSBC.

Our international reach works as well. We helped clients across 29 sectors and 60 countries, with cross-border transactions, with a notional value of more than $1 trillion. Some landmark cross-border deals includes Vale's $12.2b global equity offering, the Ford sale of Jaguar and Land Rover to Tata Motors, and being sole book runner on PetroRabigh's $1.2b IPO, the first ever by a Saudi Aramco affiliate. True testament that the markets are working between the developing teams and the developed market teams. And our progress in Global Banking and Markets was recognized by Euromoney's Best Global Emerging Markets Bank award.

The key takeaway here is that we generated a profit of $2.7b in the half, bucking the trend with a 37% increase on the second half of 2007. Even more impressive than that 37% comes with a headwind of write-downs of $3.9b in the first half versus $2.1b in the second half of 2007.

Turning now to Private Banking. Private Banking had a good half year. Pre-tax profits were up 5% to $822m, mostly down to strong performances in Switzerland and Monaco. Total client assets were stable at nearly $500b. Our emerging markets reach is growing here as well. 59% of our Private Banking business came from emerging markets. And we opened three new offices in China. Net new money from intergroup referrals increased 70% to $3.4b, more proof that ‘Joining Up the Company’ works.

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Now let's turn to Insurance. Pre-tax profits were $1.6b, 16% of the total Group profit before tax. Premium growth was up 30%, mainly driven by Latin America, the U.S. and the U.K. And this came in the main from 'Joining Up the Company' initiatives with a tight cost base. We also started operations in India and a joint venture in Korea. We now have strategic partners in 23 countries with 82 product launches agreed in the first half of 2008.

Throughout this presentation you'll have seen revenue examples of 'Joining Up the Company' taking hold. And here are some more. Our top end international Personal Financial Services proposition, Premier, attracted more than 200,000 new customers in the six months. That's 80% of them were new to bank, much more than the 50% that we were expecting. Global Links, our international referrals service for commercial customers, saw a 126% increase in cross-border referrals resulting in $5.6b of new facilities being granted. The concept of 'Joining Up the Company' is now truly embedded in this company. But we have always maintained that the real value is when the re-engineering of the cost base takes place. From the list to One HSBC Systems and Services that you can see on the screen, the re-engineering is now at the full global implementation stage. And whilst the slowing of the cost growth in the first half is impressive, there is a lot more productivity and savings to be made yet. But we are definitely on the journey of radically re-engineering this company.

So to sum up. A typical workmanlike performance from HSBC. The Managing Board takes nothing for granted and continues to tell it as it is, in a conservative and transparent manner. We are confident in demonstrating that our strategy is working. We are offsetting weakness in some markets with growing strength in others. We remain focused and resolute in working out the USA businesses whilst using our ongoing capital strength, our global distribution and our ever strengthening brand to reach out and attract new customers in all markets. We know that the biggest prize is to re-engineer the cost base through 'Joining Up the Company'. We also know our biggest asset is our 335,000 staff in 85 countries and territories, who I personally would like to thank at this stage.

The financial world is an uncertain place. But I am confident in the management's ability to stick to HSBC's driving principles of being capital strong, being self-funded, and being with its customers in the good times and the bad.

I'd now like to hand you back to Stephen.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Right. Thank you. And I'd like just to end with a few words on the outlook and the way in which we've positioned HSBC. I don't think you'll be surprised to hear me say that the near term outlook remains negative with a significant degree of uncertainty. The U.S. is weak, the U.K. has been weakening. There's pressure from inflation on growth in several fast growing economies around the world. We see a risk of declining credit availability as financial markets deleverage, which increases the risk of delinquency and default in a number of sectors. So far as emerging market growth is concerned, we do see that holding up reasonably well, albeit with less momentum than last year.

There's a lot of uncertainty around. What else can one say? So far as HSBC is concerned, we continue to pursue the implementation of our strategy. And our strategy is based on three major world trends which we do not believe are impacted by the current short-term market difficulties. The fact that emerging markets are going to grow faster than material ones. We believe that is going to continue for the foreseeable future. The fact that world trade and investment will tend to grow faster than the world economy. The fact that the ageing of the human race is creating new demands for financial services as demographic profiles change in virtually every country. These are mega-trends, if you will, on which we based our strategy, and we have spoken a great deal about that over the last 18 months to two years, and we do not believe that the current financial market turmoil has in any way called into question those major trends.

We build our strategy on the basis of some key and we believe compelling advantages. We have an extremely strong financial services brand, as Mike was saying. We have that unwavering commitment to capital and liquidity strength. And we have a broad based business with international connectivity, which we believe plays very well to the circumstances of the modern age. And to repeat, these are not changed by current short-term financial economic -- financial difficulties.

And then therefore we are the world's leading international bank in emerging markets. So we think we have a great deal to build on. But these are difficult times. And in that context we are pleased that we presented, as Mike said, a workmanlike and robust set of results.

Now, let me turn the floor over to you. Questions. What I'd like to do is just to make sure that we orchestrate the process between London and Hong Kong. If you could raise your hand and we'll get a microphone to you. In Hong Kong Vincent will invite the next question, and I will do the same for London. We would be grateful if you could tell us your name and your organization before you ask the question. And I would be

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grateful if you could try and limit yourselves to one question per turn. To avoid any confusion between London and Hong Kong, I'll choose the person to answer the question, and on any follow-ups. Vincent, would you like to take the first question?

QUESTION AND ANSWER

Vincent Cheng - ***The Hongkong and Shanghai Banking Corporation - Chairman***

Thank you, Stephen. Gentleman on the left.

Alistair Scarff - ***Merrill Lynch Hong Kong - Analyst***

Thank you. It's Alistair Scarff from Merrill Lynch, Hong Kong. Obviously congratulations on a solid set of numbers. I'm just wondering if you could provide some additional color on your balance sheet management revenues. They jump quite strongly. And the first I guess when you presented your full year results you guided that you'd increased to a duration or had take positions to protect from falling U.S. rates. Obviously there's a big jump. How's that going to decline the second half, or is your position a short-term one and could run off in terms of contribution?

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Thank you for the question. I'm going to ask Stuart to take that, if I may. Stuart.

Stuart Gulliver - ***HSBC Holdings plc –Globaal Banking and Markets, CEO***

Certainly. Yes, we positioned for falling U.S. and Hong Kong interest rates, because -- and actually falling sterling rates, because we suspected that central banks would need to ease rates given the state of the markets. As our concern about inflation has arisen, we've reduced the size of those positions. And you can actually see the positions in the VAR graph. So you can actually see when we took the positions, VAR jumped a) because we'd increased the size of positions, b) because volatility had increased. And then as volatility continued to increase and we reduced the size of the position, the VAR stayed more or less where it was and then dropped off into June 30. So you should not look to the same number for balance sheet management in the second half as the first. But the second half should be higher than either of the halves, one or two, of 2007.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Thank you. A question from here, please.

Tom Rayner - ***Citigroup - Analyst***

Yes. Thanks very much. It's Tom Rayner from Citigroup. Could I ask one question with two parts, please? The first on your delinquency trends in the U.S. The second on your write-down and you financial exposures.

Just on the delinquency trends we're seeing come through in the U.S. Consumer Finance business. They seem to be leveling off in the second quarter in every asset class except maybe the branch generated mortgages. I just wondered if you could update us on your thoughts going forward, and also what you're seeing in terms of loss severity, whether house price movements are making you reassess the loss severity as well as where the delinquencies are going. And I have a second follow-up part of the question, thanks.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Tom, right. Well, if I can preface it by saying you wouldn't expect me to make a forecast for the second half, would you? And not merely would I not do that in general, but these are particularly uncertain times. And I think it would be folly for us to go projecting out what has been a -- you

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referred to it, in most categories a leveling off or a slight improvement in the second quarter except in Consumer Lending. Douglas, do you want to talk to -- ?

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

Yes. I think the drivers of the delinquency rates are a number of factors. Clearly a slowing U.S. economy is adversely hitting real state secured and unsecured, probably unsecured more. But the fact the book is coming down is elevating two plus delinquency as a percentage, but keeping the dollar amount of delinquency particularly in real estate lending relatively flat.

In terms of severity, we have seen a tick up in real estate severity in the first half of this year, but not a dramatic one. And I think encouragingly, all through the first half of this year we've seen a relatively -- a very stable position in relation to those homes that we end up having to own. We've been able to move those homes on with roundabout the same loss and disposal within 180 days. It's been 180 days for the last two and a bit years, which I think is encouraging, saying that there is a market at the bottom end for standard homes.

The other place we're seeing a little bit higher severity, which is one of the reasons we've taken the actions we have in terms of the stopping origination is Auto because of the lack of interest or declining interest in SUVs and trucks because of fuel costs. So the severities on repossessed vehicles is rising there. But I think the thing I would say, broad picture, particularly with secure, is that there -- since we stopped underwriting in Mortgage Services in the middle of '06, the portfolio's now at least two years old. And therefore the underwriting issues are through the system. And what we're now exposed to is economic factors. And that's now what's driving the book.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

You want to get in your second part?

Tom Rayner - ***Citigroup - Analyst***

Yes, thanks. I'm just trying to get a sense for why the AFS reserve hits the magnitude was so much bigger in Q2. We weren't seeing these sorts of trends coming through in the first quarter. I was just trying to get a sense for what has deteriorated to make those sort of marks that much more significant.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Douglas?

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

Credit spread widening. We saw credit spread widening and that was that. That was the major thing. As you're aware, the accounting is also quite curious in the sense that the --

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Stephen Green - ***HSBC Holdings plc - Group Chairman***

We need a Finance Director to say that kind of thing.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

Yes, very curious. In the sense that the mark to market obviously reflects issues on credit issues on asset preference and liquidity preference, all of which goes into the AFS reserve. We then do a security by security analysis as to whether we think the cash flows are impaired, to see whether in fact any of that fair value movement that's gone to reserves needs to be recycled. And very little did, which shows that the vast majority of what we're recognizing is today about liquidity and asset preference. But the accounting as such that to the extent that you get any impairment in cash flows, you take the whole of the deficit that's gone to reserves back through the P&L account. And for us that was only $55m in the quarter, sorry, in the half. But the movement is simply more illiquid markets and wider credit spreads as a result.

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Stephen Green - ***HSBC Holdings plc - Group Chairman***

Stuart, do you want to add anything?

Stuart Gulliver - ***HSBC Holdings plc – Global Banking and Markets, CEO***

I think also, the reason why it increased in the second quarter was because second quarter is when a number of banks raise equity capital. And the underwriters for that equity capital raising would have gone through and done a due diligence on their assets and forced them to mark down to the most conservative position. Because they obviously have legal underwriting and capital at risk and underwriting the deals. And the second quarter is basically when a lot of bank capital was raised. So therefore we're going to be impacted by a general markdown on equivalent assets that's taking place across the market.

Tom Rayner - ***Citigroup - Analyst***

Thank you.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Can we take a question from Hong Kong, Vincent?

Vincent Cheng -***The Hongkong and Shanghai Banking Corporation - Chairman***

Thank you, Stephen. Gentleman in front?

Unidentified Audience Member

Okay. I've got two questions but one of them's a simple factual question, I might have missed that. But has the gain on the head office sale been booked? Or is there a sense on timing on that?

And the second question is, the goodwill impairment charge taken at HFC at the subsidiary level and at the Head Office, there still seems to be a difference. Could you give us a sense whether you would be taking a charge and goodwill at the Group level? Thanks.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Well, on the first question the answer's no. It has not been taken in these results. On goodwill, Douglas?

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

The goodwill impairment is just over $500m. It is different from what was taken in the U.S. and that's simply because the cash generating units that are assessed in each of the analyses are different in the finance company. The cash generating units were each of auto Mortgage Services, Consumer Lending and cards, and all of the goodwill was written off with the exception of cards. We look at the cash generating units as North American PFS and aggregate. And therefore we have three, four, very positive units, cards, retail banking in the U.S., retail banking in Canada and retail banking in Bermuda. And then we have the more problem portfolios in real estate, secured and Consumer Lending. The aggregate at the end of last year was a surplus. When we redid the calculation at the end of June this year there was a deficit. And that deficit's been reflected through the profit and loss account. So a non-cash item, but that's the way the numbers came out.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

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Question from -- yes. Middle. Sorry, come back.

Arturo de Frias - ***Dresdner Kleinwort - Analyst***

Hello, Arturo de Frias from Dresdner Kleinwort. Also a question on capital with the relation into dividend, you were discussing before your AFS reserve, which is obviously not impacting your core Tier 1, but it is impacting your tangible equity or your tangible NAV.

Because the AFS reserve has increased substantially, if I am correct, and your shareholder's equity is pretty much stable, if I am correct your tangible NAV has fallen more than 10% from December, around $10b, which is of course, a substantial decrease.

You said that is mainly because of spreads widening, and mainly because of some investment banks taking higher marks. But we just saw Merrill Lynch taking much higher marks than anybody else. So we could see the trend continuing, and we could see the spreads widening. And if that's the case we could see additional AFS reserve increases, which in turn could increase -- sorry, could decrease even more the capital.

Is -- there is a point where you start to be concerned? Not with your core Tier I, because again the AFS reserve doesn't impact it, but with your tangible NAV, with your shareholders equity.

And then the derivation into dividends. I was also looking in your information, that in this first half the payout ratio, the dividend payout ratio has been very high, has been 88% because of the obviously much smaller EPS.

If we were to continue to see additional write downs in the U.S., and we were to continue to see flattish EPS going forward, there is a point when you reconsider your dividend? Because obviously you cannot keep nearly 90% dividend payout ratio for long. Many thanks.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Well just on the very last point we review our dividends as we go. So, we've announced the first, second and third dividends, we did so at the time when we produced our annual results and that's for that. Douglas.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

The -- let me deal with the payout ratio first. The payout ratios I would argue isn't 88%. The way IFRS works you take not the two dividends we've declared in this period i.e. 18 plus 18, but you take the last dividend for the closing dividend for last year. So you get a disproportionately high dividend in the first half. We still look at in an old fashioned basis of attribute allocation of profits, so its $0.36 out of $0.65.

I'll need to look at your numbers on tangible book because shareholders' funds are basically flat. So that's -- and that's after the AFS write downs that you've talked about, which as you alluded to, do not have an impact for capital, but shareholders' funds are flat.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

A question from Hong Kong?

Vincent Cheng - ***The Hongkong and Shanghai Banking Corporation - Chairman***

Gentleman in front.

Cameron Odgers - ***CICC - Analyst***

Hi, Cameron Odgers from CICC. I am a little bit confused on your write downs, the AFS that you listed in page 15. Now the first loss protection is for the market value loss or the credit loss? Page 15 of the presentation.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

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The answer is both, market loss and credit loss.

Cameron Odgers - ***CICC - Analyst***

So the original face value of the first loss was $1.8b. Correct? And it was $1.3b at the beginning of 2008? So these losses essentially wipes that out these write downs?

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

No, the -- in respect of the positions where there is first loss protection there is a market value write down that's gone to reserves. We would then assess to what extent is that market value write down represented by deficiency of cash flow and therefore impairment.

And that measures at $134m. We don't have to recognize that $134m because we've got $1.3b of protection from first loss protection, essentially the note holders and the conduits.

To the extent that further of the fair value adjustment or mark comes to impairment, then once it exhausts the $1.3b of residual protection that we have then we would be exposed. But we think we are a very, very long way from that.

And indeed, again, the impairment of $134m is a reversal of the deficit that had gone to the AFS reserve. The actual impairment measured is less than that. So, we think we have a considerable amount of protection on those assets.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

A question from here, yes that I missed last time. Thank you.

Tim Sykes - ***Execution - Analyst***

Thanks Stephen, its Tim Sykes from Execution. Just a quick question on the U.S., when we last met you talked about 1,000 branches in the U.S. and that being the right size. Since then, obviously there's 100 branches gone and also you've decided to run off the auto portfolio.

Is there a fundamental shift in what you see as the residual business in HFC? I think we thought before that with the portfolios that had been run off you'd be looking at something like $100b of residual assets and 1,000 branches, and then the business that you can grow. Have you reassessed that?

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Mike.

Michael Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

Well firstly you are right we are looking for $100b worth of assets. We've trimmed the branch network a few here and there. I wouldn't take anything in between 900 and 1,000 as just geographical spread.

On the auto finance side, basically we are driving the business through the discipline of what is the long term return on equity we can make from various different businesses if we are going to run the business on a 15% to 19% ROE. We looked at this business and said have we got critical mass? Have we got pricing power? What's the credit outlook for this sector?

All of those things we've said, actually credit quality is actually quite strong, and this is the time to unwind this business, because there is just not a return of equity and we put that equity to work somewhere else in the business. There is a lot of equity tied up in that business, so we are just adjusting, and on the journey to get down to the $100b.

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Tim Sykes *- Execution - Analyst*

Thank you. Sorry, very, very quickly if I can. Stuart could you comment on the factors which have driven the strong performance in rates in FX and their durability into the second half please?

Stuart Gulliver *- HSBC Holdings plc – Global Banking and Markets, CEO*

Rates and FX have both benefited from very high levels of volatility in G3 markets, and that's obviously central banks A, cutting rates, and then B, the uncertain outlook in terms of inflation has created volatility which we've been able to trade correctly.

But also in emerging markets, because throughout some of the Middle Eastern countries you've had speculation about revaluations, which of course, made an enormous increase in client interest in hedging. And in the emerging markets of Asia-Pacific again there's been reasonable levels of volatility, so therefore reasonable levels of client activity.

Most of my FX business is actually client based. It's not prop it's by far the main -- the majority of it is client facing. And there are big levels of volatility, increasing levels, therefore of hedging requirements in FX and the same really applies in rates. Very uncertain markets, which we are all dealing with actually in the area of rates and FX create big hedging opportunities and trading opportunities.

Stephen Green *- HSBC Holdings plc - Group Chairman*

Stuart, thank you. Vincent in Hong Kong please.

Vincent Cheng *- The Hongkong and Shanghai Banking Corporation - Chairman*

Thank you Stephen, gentlema n.

John Wadley *- UBS - Analyst*

Hello. Okay, thank you. It's John Wadley from UBS. Can you explain on page 220 on the derivative exposures? You've increased the credit derivatives in the past half year, and I just want to understand what your feeling is about counter party risk in the derivatives market. And how you manage the risk, given that you have increased credit derivatives over the past year quite a lot, and report about $2 trillion of gross credit derivative exposures.

So I just wanted to understand how much of your revenue are you generating from this area of business activity, and what do you assess as a risk?

Stephen Green *- HSBC Holdings plc - Group Chairman*

John, thank you for the question, I'd like to -- Douglas maybe comment on the numbers and then put Stuart on the business indications.

Douglas Flint *- HSBC Holdings plc - Group Finance Director*

You've seen in the balance sheet that both the fair value of assets on liabilities, derivative assets on liabilities has moved out markedly. And that's primarily to do with spread widening in the period rather than increase in business volume. There are some elements of that, but the big impact has just been the fair market value on both sides of the balance sheet.

And again to make the boring accounting point, if you look at European banks again the U.S. banks we have much bigger figures because we are not allowed to net for accounting purposes, for our credit support agreements and credit mitigation in effect, because we don't intend to settle net. Whereas the Americans net down to a net market risk exposure we gross up. But that's really it. Stuart from the business perspective.

Stuart Gulliver *- HSBC Holdings plc – Global Banking and Markets, CEO*

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From the business point of view, yes, the counter party risk is a significant issue I think for the entire industry. Transaction and hedging with counter parties who then themselves aren't solvent at the point you wish to call on the hedge is obviously something we are all facing as a challenge.

And indeed I think it is something that a report that Douglas has been involved in with Corrigan, which gets published later this week, is looking to make some recommendations.

I think ultimately the credit derivative market will move to some sort of exchange based mutual collateralization type of market to take out the counter party risk. And we will be huge supporters of that, because it is a residual risk that's effectively -- in a way creates concentration, because you end up with a few counter parties, because you are obviously trying to avoid same way around risk. That creates a new risk, which is rounded up with the majority of the spread at derivative but with four or five counter parties.

Ultimately this will get solved by exchange type of mutual collateralization process, which as I say Douglas and others who have been involved in this Corrigan report are recommending.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Stuart, thank you. Here in London Simon.

Simon Samuels - ***Citigroup - Analyst***

Thanks. Morning, it's Simon Samuels at Citigroup. I kind of partly wanted to pick up on that last point actually as well. It's -- if I look at your loans deposit ratio as a Group you are running about 90 -- early 90%, which is a kind of very low number compared to other banks in the world, but obviously is a lot higher than you used to be 10 years ago. I also look at things like your borrowings from other banks just exceeding $150b at the moment.

And I guess the two part question to that really is first of all do you see any signs that you are coming up against any counter parties limits on the other side? So, essentially my point is are you becoming too big to fund yourself in wholesale markets? Any signs of that because you are a single name?

And then secondly linked to that if you rolled the Group's balance sheet forward several years from here would you expect that loans deposit ratio to kind of start unwinding back down again meaningfully maybe to a level it had been say 10 years ago?

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Douglas, this is really one for you. To the first question the answer is very clearly no.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

Funding issues, no. A lot of the liabilities to banks reflect their deposits with us and indeed simple trading accounts and, therefore, not essentially funding. I think we are very comfortable with an advance deposit ratio in the kind of space where it is just now. So I wouldn't see it moving dramatically differently from where it was.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

I agree with that. You wouldn't want to see it rise much.

Simon Samuels - ***Citigroup - Analyst***

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If I can just follow up on that? I just think about the implications for your acquisition policy then, does it follow from that that any meaningful acquisitions would have to be essentially self funded from a loans deposit relationship perspective?

Stephen Green - ***HSBC Holdings plc - Group Chairman***

I think, largely speaking, it does follow from -- there are a number of other points I'd make about acquisitions, one is they've got to fit into the Group strategy. You don't buy something because it's cheap. And I think you would look at the way in which the business you were acquiring was funded. Absolutely yes. I think it is one of the key criteria.

Question from Hong Kong Vincent.

Vincent Cheng - ***The Hongkong and Shanbhai Banking Corporation - Chairman***

Thank you Stephen, the gentleman there.

Nick Lord - ***Macquarie - Analyst***

Yes, good morning. It's Nick Lord from Macquarie. Going back actually onto your Global Banking and Markets revenues in the first half. I seem to remember when you did the interim management statement one of the comments you made was that you'd had a very good first quarter because of that hedging, but activity had dropped off after the first quarter.

I wonder if you could comment on the split first quarter second half ex the losses and whether or not that statement still holds true?

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Yes Nick. Thank you. Stuart.

Stuart Gulliver - ***HSBC Holdings plc – Global Banking and Markets, CEO***

The second quarter was slightly slower than the first quarter, so we were probably slightly gloomier than the actual outturn, because volatility spiked higher. In May and June it spiked higher again. But it was definitely the case that the second quarter was slower than the first.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Robert.

Robert Law - ***Lehman Brothers - Analyst***

Thanks. Robert Law of Lehman. My question concerns Hong Kong and the erosion particularly in the cost income ratio there. Certainly Hong Kong contribution overall was lower than I had, and you've grown the cost base by about 20%. Could you comment on some of the reasons for that, and whether you'd view that as the kind of level of ratio that you'd be running at in the future?

Stephen Green - ***HSBC Holdings plc - Group Chairman***

I think that's a very good question. Mike, would you like to turn to that, and maybe Sandy after you, Mike.

Michael Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

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Well, firstly clearly growing the business in Hong Kong, remember Hong Kong takes -- there is a lot of business -- cost base is spread out across the region. But the fact of the matter is we have been investing in the business. And we continue to see the growth in that business long term.

And you wouldn't expect us to stand back, because our organic strategy is what we are implementing. And it's in the region that we want to do. But I am happy to let Sandy go drill down to the particular elements.

Stephen Green *- HSBC Holdings plc - Group Chairman*

Sandy?

Sandy Flockhart *- The Hongkong and Shanghai Banking Corporation - CEO*

On Hong Kong, obviously in Hong Kong with the drop in markets and with some of our investments as well these came through to the bottom line through P&L. So if you take, in fact, the core businesses of Global Banking and Markets PFS and Commercial Banking they were up. But there was a drag caused by impairment charges that were taken through the books in the first half.

Inflation is an issue going forward. We are cognizant of that fact, and we've been very careful in terms of recruitment going forward, in terms of the Hong Kong business as a whole. So I think you will see that our investments in terms of number of employees etc will reduce as we move into the second half of the year.

But the underlying businesses is sound, it is still growing. But there have been issues caused particularly by equity markets, and that's come through, as I said, impairments on the investments, and equally as well in our insurance -- in reserves. So these are the main factors that have caused that drag down in terms of overall comparisons with the second half of '07, which is a very strong half year.

Stephen Green *- HSBC Holdings plc - Group Chairman*

Sandy, thank you. A few questions from -- yes please.

Ian Smillie *- ABN Amro - Analyst*

It's Ian Smillie from ABN Amro. Can I invite you to add some color to your deposit performance, which looked to have slowed down fairly sharply after a strong second half last year?

And in particular it looks like deposits in Hong Kong and North America both went backwards. So if you could just color in for us what's happening there, and perhaps give us some sense as to what we should expect in the deposit performance going forward please?

Michael Geoghegan *- HSBC Holdings plc - Group Chief Executive*

Well I'll take it. Firstly you've got to look at overnight deposits in Hong Kong, 0.01% is the rate we are paying for them. The reality is you've just got to be careful of the liquidity we attract, because we have to place it in the market.

And basically what many people are doing and your institutions as well, are pushing the risk to us. In other words we are being asked to take deposits on your behalf, and then we are taking the risk of placing them back into the financial -- into financial institutions. So we have been curtailing back on that, but you shouldn't read anything into that.

On the USA, as we said in the commentary, we are -- our direct business there experienced stiff competition from others trying to attract deposits as well. And as we are self-funding ourselves at the bank level there we didn't go out overly actively to build the deposit base there. But we are staying in the market and taking some P&L impact on it.

But there is no change in the strategy. But we've just got to realistic that we just take funding to meet our customer requirements and don't build out our funding to meet your desire to move the risk to us.

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Ian Smillie *- ABN Amro - Analyst*

So we should expect the second half to be more of the same of the first half rather than more like last year?

Michael Geoghegan *- HSBC Holdings plc - Group Chief Executive*

A lot depends on interest rates particularly in emerging markets with inflation there. If interest rates begin to rise then it may well be that we will take funding. It depends on a lot of market conditions.

Stephen Green *- HSBC Holdings plc - Group Chairman*

A lot depends on market confidence in other institutions.

Ian Smillie *- ABN Amro - Analyst*

Thank you.

Stephen Green *- HSBC Holdings plc - Group Chairman*

Vincent, you got any questions from Hong Kong?

Vincent Cheng *- The Hongkong and Shanghai Banking Corporation - Chairman*

Just one.

Bill Stacey – *Aviate Globa* - ***Analyst***

Bill Stacey from Aviate. My question is about the credit card portfolio in the United States, which has performed exceptionally well relative to their peers in this quarter. I wonder if you could elaborate on the reasons why you think that portfolio has performed well, especially given the comments that you made earlier. That you felt you were ahead of the curve in dealing with mortgage issues, and the outlook comments you made without making forward-looking statements about Vehicle Finance where you said you expected the credit risk to deteriorate going forward.

Stephen Green *- HSBC Holdings plc - Group Chairman*

Mike?

Michael Geoghegan *- HSBC Holdings plc - Group Chief Executive*

Well firstly, we go back to 2006, end of 2006 early 2007 when we saw the credit quality in the mortgage book deteriorate. We obviously looked at the business there and then and looked very carefully at the scoring etc for it.

Do bear in mind that's a 50% prime business and 50% subprime business. And it's very broadly spread. So the average credit limit for the subprime business is about $300. It's driven much more off what unemployment is doing. And as I said in the presentation, so far we don't see a deterioration.

Clearly if unemployment was to increase we could expect that to happen. But it's a very conservative approach that we've taken to it. But we are not totally covered, but we went back to 2000 and late 2006 and changed our models before others had and that's the result.

Stephen Green *- HSBC Holdings plc - Group Chairman*

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Any questions from London? Alistair.

Alistair Ryan *- UBS - Analyst*

Thanks Stephen. It's Alistair Ryan at UBS. A question about assets and risk assets in North America. On page 202 Household has got whacked under Basel II. Probably the more striking figure, which hasn't changed that much but is still over 10% of Group risk weighted assets, is the bank. And a lot of that presumably is tied up in Global Banking and Markets with its $243b of gross assets.

Do you need that balance sheet in the States now? Household presumably is -- you are working through Basel II, you've kicked out the autos book. There must be other parts of Household that look less favorable under Basel II.

Speaking from a house that's been consistently disappointed with the United States over the last few years, the U.S. Global Banking and Markets business was always the under performer before the credit crisis. Do you need that much gross and risk weighted assets tied up there? Thanks.

Stephen Green *- HSBC Holdings plc - Group Chairman*

Alistair, if I may say I think those are well taken questions both of them and we are hard at work on this. And I -- well go on say it, I think that -- well you know what we are doing about our Consumer Finance business. The outcome will be a smaller balance sheet than it now is.

We do believe that you've got to work your way through the difficult times and stabilize the business, and that there is real value in the Consumer Lending business. And there is certainly real value in the credit card business. I don't think anybody would question that.

Where we are now at with the announced termination of new business in auto finance is in effect two businesses under the Consumer Finance heading in the U.S., the credit card business, which by any standards is strategically significant to a Group like us that's in Personal Financial Services around the world, and the Consumer Lending business.

But the Consumer Lending business has value in a -- as the U.S. market normalizes, and it will of course normalize, I think it's beyond question. But we've got a short term management stream of challenge.

On the bank we have shrunk our Global Banking and Markets business, and Stuart, do you now want to take up the story?

Stuart Gulliver *- HSBC Holdings plc – Global Banking and Markets CEO*

The Global Banking and Markets in the States, we've cut the headcount actually from about 1,800 to 1,000. We closed mortgage backed trading in the fourth quarter of last year. And in the first half of this year we've reorganized to have an Americas organization structure.

So the business now is organized Latin America and North America, with New York repositioned in essence to cover cross-border flows, so Middle East investing into the U.S., U.S. investors going into Asia, going into India to pick up effectively the Latin American emerging market piece, because the center, the hub for Latin American DCM and derivatives is New York, and to be the New York leg of a successful foreign exchange business.

So what you see is a bunch of effectively legacy portfolios that are in management or runoff. So the actual size or scale of the balance sheet will be defined more by what PFS raises in terms of deposits, what asset pools will move across from Household than it will be by Global Banking and Markets business.

Douglas Flint *- HSBC Holdings plc - Group Finance Director*

If I could make one other point of clarification on this. As you see in that page the December and the June '07 figures are Basel I because that was the capital framework we were under.

You are absolutely right, to use your terminology, HSBC did get whacked by Basel II. But in the first half of this year those weighted assets declined meaningfully. So they went up in that figure of 180 whatever it is, at the end of June is less than it was at the beginning of the year.

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Stephen Green - ***HSBC Holdings plc - Group Chairman***

Vincent a question from Hong Kong.

Chi Cheng - ***Eton Park - Analyst***

[Chi Cheng] from Eton Park. Congratulations on a solid result. Can I ask you the question on Tier -- your core Tier I capital? You have unrealized losses available for sale that have securities of $9b. It's an increase of $6.6b from the year end. And can you comment on that?

And in the footnote you say under IFRS rules these should be excluded from your capital resources. So if I exclude it its -- or your core Tier I ratio is 7%. Can you also comment on that? Thank you.

Douglas Flint - ***HSBC Holdings plc - Group Finance Director***

Well on [regards] the framework available for sale losses the available for sale losses and indeed the available for sale don't count for capital. So that's why they are an add back from getting from shareholders' funds from which they've been deducted to Tier I capital in which they are included. So they don't have an impact on capital.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Questions from here, please.

Michael Helsby - ***Morgan Stanley - Analyst***

Thanks I've got some -- its Michael Helsby from Morgan Stanley. I've just got two related questions on your Group targets. Firstly is on the ROE, first half result comes in at 12% that's clearly less than the overall 15%.

I just want to clarify if -- will you be including the gains from CCF and head office when you are measuring yourself about your 15% target?

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Yes. It would do.

Michael Helsby - ***Morgan Stanley - Analyst***

If you were to exclude them would you still be comfortable that you'd meet the target?

Stephen Green - ***HSBC Holdings plc - Group Chairman***

We are not forecasting whether or not we will meet the target. We didn't in the first half. What we've always said -- well always, we announced this target to the -- at the -- when we presented our full year results. This was a target that we would seek to aim for broadly through the cycle.

We've never expected that we would hit it every single year. And if there was every an occasion when you are going to struggle to achieve an ROE target is these kinds of circumstances. But to be clear, yes, profits that would come from the sale -- the disposal of assets would be included, yes.

Michael Helsby - ***Morgan Stanley - Analyst***

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Thanks that's good. And just on the capital ratios, I notice in your calculation of core Tier I you include the minority and the pref, But take that out its 7.2%. And I was just wondering if you would give us a feel for -- or if you would have a target. You've given us a Tier I target, if you would have a target or were you -- do you feel the core Tier I level where you'd be comfortable at.

Douglas Flint *- HSBC Holdings plc - Group Finance Director*

Well, we are comfortable where it is. We are happy where it is and you have to add in the minority interest, because you've added in their share of the assets. So without adding that in you'd get a rather punishment on the capital ratios.

Stephen Green *- HSBC Holdings plc - Group Chairman*

I think your question was the 7.5% to 9% is a range for Tier I, you were asking in effect what is our range for core Tier I.

Michael Helsby *- Morgan Stanley - Analyst*

Exactly.

Stephen Green *- HSBC Holdings plc - Group Chairman*

And I think the answer -- well we haven't published a range, but we are comfortable with it where it is.

I don't think there are any questions in Hong Kong, a couple of final ones from London. Yes, please.

Sandy Chen *- Panmure Gordon - Analyst*

Morning, its Sandy Chen from Panmure Gordon. Just trying to tie together the AFS comments you made as well as the counter party default risk comments that Stuart had made.

The -- my concern is -- or the question is really what would trigger the movement from the AFS on to the P&L, drilling down into your comment about the impairment of the cash flows. And specifically, I am looking at page 120 and 126, on the $17.5b of Alt A exposure it looks like you've recognized about $3.2b of AFS charges against that. And the '06 and '07 vintages look like they total about $15b, and also tying that together with the roughly $14.6b in notional contract exposures on monolines.

Now, if there were, for example, counter party -- significant counter party default risks that increased, particularly on the credit derivatives exposure, could that -- do you see potentially a jump risk if a couple of those significant counter parties went into -- were to default or be significantly downgraded that would then trigger a recognition of impairment on those cash flows?

Stephen Green *- HSBC Holdings plc - Group Chairman*

let me suggest that Douglas answers -- takes the question from the strict -- from the accounting point of view, and Stuart you may want to add something too.

Douglas Flint *- HSBC Holdings plc - Group Finance Director*

Elsewhere in this market turmoil section, which I think has added 40 pages. There is a very, very granular description of how we test for impairment, which is on a security by security basis.

First of all identifying those that have had a market value loss then going into the underlying securities within the structure and our position within them, then estimating the fault rates and the flow through the default rates to delinquency so that one can see where the waterfall of cash flow arises, and where it gets attributed to, and looking where we are in the capital structure.

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And to what extent there is likely to be a cash flow deficiency for the paper that we have in the counter structure. So it's incredibly difficult to make a comparison against anybody else.

Only if we end up with efficiency in the cash flow do we end up with impairment as (inaudible). As said we recycle the whole of the deficit that's sitting in the available for sale reserve through the profit and loss account.

The fact that we don't have very much impairment indicates that we have positions that are high up the capital structure, or that the particular vintages where we hold the paper are better than others. And that's -- it's done on a very granular basis. We are where we are.

Clearly if default rates rise then there is more risk of impairment. And we would measure that and report that and explain that at the time. But at the moment, I believe, we've done this incredibly conservatively.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Stuart.

Stuart Gulliver - ***HSBC Holdings plc – Global Banking and Markets, CEO***

I have little to add other than to say this, if your question is if there was a failure of the top five banks in the world would we lose money. The answer is yes. But you won't -- that's nothing to do with my AFS positions or my exposure to monolines, where I agree with Douglas we've been very conservative. And where we've got transparency from other counter parties where they've marked, we are comfortable that we are very conservative.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

We've probably got time for one more question.

Leigh Goodwin - ***Fox-Pitt Kelton - Analyst***

Good morning, it's Leigh Goodwin from Fox-Pitt Kelton. Actually just a question on impairment trends within Europe. Seems as if there is a flattening out in the commercial side, some small tick up on the PFS side.

I wonder if you might give us some indication of where you see those charges going. And it's to your credit you've been very cautious in expanding on the asset side. But nonetheless how do you see the trends moving there.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Yes. Thank you. That's a well taken question because the U.K. economy is weakening. Mike.

Michael Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

The results out of the U.K. are impressive by anybody's measure, and the reality is that back in end of 2006 when we saw the problems in the USA we didn't believe the world was decoupled. So we went and looked at our books here in the U.K. and said what -- if these things happened.

And we changed the credit score and the profile so we reduced our exposure to personal unsecured loans. We looked at our credit card portfolio. We lost market share -- or we gave up market share in mortgages. And all those things are now holding us in good stead.

Now, on the commercial book my concern is, as balance sheets contract of other banks who either can't fund or haven't got capital, will that impact their relationship with their customer who where we may also have facilities. And that's my sort of look out to the future. We've got to be careful of that, and the team are looking very carefully at that.

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The great thing about HSBC, because we are in the long term business, we look at our clients over the long term. So we generally build those relationships for the long term. We very much encourage our relationship managers not to build balance sheets but build relationships, and that's what they've been doing. And I think that will help us do the best we possibly can.

But it goes to Stuart's position, if the top five bank goes down then there is obviously a reality that it's going to have an impact to us in all our business segments.

Stephen Green *- HSBC Holdings plc - Group Chairman*

We probably ought to call it a day at that. To our friends in Hong Kong, thank you very much for joining us, Vincent thank you. And thank you for joining us here too. Thank you very much.

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