2012 Interim Management Statement

Presentation to Investors and Analysts

8 May 2012, 11.00 am BST

Operator

Good morning, ladies and gentlemen, and welcome to the HSBC Holdings plc investors' and analysts' conference call. For your information this conference is being recorded.

At this time, I would like to hand the call over to your hosts, Stuart Gulliver, Group Chief Executive, and Iain Mackay, Group Finance Director.

Stuart Gulliver, Group Chief Executive

Thank you. Welcome, everyone. Iain's together with me today, and first of all we'll give you a quick overview and then, obviously, move to questions.

So we've had a good start to the year. Reported PBT for Q1, which includes obviously the adverse movements on the fair value of our own debt of $2.6 billion due to the tightening of credit spreads, was $4.3 billion.

The underlying numbers, which exclude the fair value of our own debt, give a clearer picture of year-on-year performance. The underlying PBT in Q1 was $6.8 billion, up $1.4 billion on 2011. The estimated ROE, excluding the effect of the fair value of our own debt, was around 11%.

Now, the main factors driving this upswing against the same period last year were increased revenues across Global Banking and Markets and Commercial Banking, and in Retail Banking and Wealth Management in the faster-growing regions.

The underlying PBT was up $3.4 billion against the previous quarter, driven by higher revenues in Global Banking and Markets which, like others in the industry, is usually strong in the first quarter; lower loan impairment charges in North America and Europe, compared with the previous quarter; and lower operating costs, due to a significant decrease in the size and number of notable items.

We continue to reap the benefit of investment in faster-growing markets. The reported PBT increased by 21% in Hong Kong, 24% in the rest of Asia-Pacific, and 11% in Latin America over the corresponding period in 2011.

The underlying cost-efficiency ratio improved from 58.7% to 55.5%, driven by increased revenues. Operating expenses were slightly higher on a constant currency basis due to the increase in Global Banking and Markets' performance-related costs. This reflects the higher revenues mentioned earlier.

However, headcount fell 14,000 against the same period in 2011, and 3,500 against the end of last year. We also announced 11 transactions since the start of the year, bringing the total to 27.

To conclude, we think it's a pretty good start to the year; continued growth in target areas, stable costs and a strong balance sheet. We've made progress in all areas of our strategy, including the costs.

And now Iain will talk through the financial performance in detail.

Iain Mackay, Group Finance Director

Thanks, Stuart. You've all seen the statement, so I'll just cover a few key points in detail.

As Stuart said, reported profit before tax for the first quarter was down, driven by effects of movements in credit spread and fair value on debt. Underlying profit before tax for the quarter was $6.8 billion; up $1.4 billion, or 25%, on 2011.

This reflects increased revenue in Global Banking and Markets and Commercial Banking and in faster-growing regions for Retail Banking and Wealth Management, and stable loan impairment charges, with reduced charges in North America offsetting the effect of higher charges in Latin America. As Stuart mentioned, the estimated underlying return on equity was around 11%.

Turning to revenues, reported revenues for the quarter were down $800 million on the same period in 2011. Excluding the effect of fair value on debt movements, revenues were $1.2 billion

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higher than in the corresponding quarter last year. This growth was led by Global Banking and Markets increasing revenues by $700 million, and backed up by a strong performance in Commercial Banking, which grew by $300 million.

Global Banking and Markets' revenue growth was driven by strong revenue performances in foreign exchange, balance sheet management and payments and cash management, and increased rates revenues, thanks to tightened eurozone bond spreads following ECB action, although this was partly offset by a decline in equities' revenues due to markedly decreased revenues on the comparable period of last year.

Revenues increased in Commercial Banking in the first quarter compared to the same period in 2011, due to higher net interest income, reflecting strong growth in lending, particularly in the first half of last year, in Hong Kong, rest of Asia-Pacific, Latin America and Europe, notably to small and medium-sized enterprises in the UK, and an increase in deposit balances in Europe, Hong Kong and the rest of Asia-Pacific.

Gains from cross selling between Commercial Banking and Global Banking and Markets, particularly foreign exchange products, demonstrated real progress in our efforts to integrate the two businesses.

Within Retail Banking and Wealth Management, we grew net interest income in faster-growing regions and insurance revenues, mainly in Hong Kong, although these factors were partially offset by the ongoing runoff of the US Consumer Finance portfolio.

Lower impairment charges were broadly in line with Q1 2011. In North America these were $500 million less than last year. This reflects a reduction in the balances and improvements in delinquency trends in the run-off CML and Card and Retail Services portfolios, and the increase in our LICs that we made in the first quarter of 2011 to reflect changes in economic assumptions about the pace of recovery of home prices and delays in the timing of expected cash flows relating, primarily, to extended foreclosure processes.

These factors continue to affect performance, but to a lesser extent than in the same quarter in 2011.

Loan impairment charges grew in Latin America, driven by increased delinquencies in Brazil, following strong balance sheet growth in previous periods.

Turning to costs, operating expenses of $10.4 billion were broadly in line with the corresponding period last year. However, they were $200 million higher on a constant currency basis; reflecting higher Global Banking and Markets' performance costs, due to higher revenues and wage inflation in the faster-growing markets. That said, the ratio of compensation to net operating income in Global Banking and Markets remain in line with that of the full year 2011.

Operating expenses in both periods included provisions for the potential mis-selling of PPI. This provision was $468 million in 1Q '12, compared with $440 million in the first quarter of last year.

Operating expenses were $800 million lower compared to the previous quarter, due to the reduced impact of notable cost items. Excluding these items, operating expenses were broadly in line with the previous quarter.

Our underlying cost-efficiency ratio improved in the first quarter to 55.5%, compared with 58.7% and 66.8% in the first and the fourth quarters of 2011 respectively. This reflected the benefit of higher revenues and controlled expenditures.

During the first quarter, we achieved a further $300 million of sustainable saves through our organization effectiveness program. This is in addition to the $900 million achieved during 2011. Taken together, and on an annualized basis, we've now achieved $2 billion of sustainable saves.

Taking a quick look at the balance sheet, excluding foreign exchange movements and a reduction in reverse repo balances, we grew loans and advances to customers during the quarter by $4.7 billion.

This was impacted by the continued decline in lending balances in the run-off portfolios in North America, along with the reclassification to assets held for sale of loans and advances relating to disposal of certain non-strategic Retail Banking and Wealth Management banking operations in the rest of Asia-Pacific.

Commercial Banking lending remained broadly flat compared with the previous quarter, following the significant growth of the last two years.

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Turning to Group's capital position, risk weighted assets remain broadly unchanged with a decrease of $7.2 billion, excluding foreign exchange differences. While we saw a $14.4 billion decrease in RWAs as a consequence of reduced risk in our trading portfolio and reduced market volatility, this was offset by an increase of $7.2 billion in RWAs on the back of loan growth in mainland China associates.

We generated $1.8 billion of capital in Q1. And, whilst risk weighted assets remain broadly in line with the year end, we increased our core Tier 1 capital ratio to 10.4%, from 10.1% at the end of 2011.

Now, let me hand it back to Stuart.

Stuart Gulliver, Group Chief Executive

Iain, thanks very much. If I can just remind everyone, we've got a strategy day next week, so rather than preview the strategy day, hopefully we can focus the questions on the data and this set of numbers. So if I can ask the operator to set up the process for questions.

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Questions & Answers

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Stuart Gulliver, Group Chief Executive

Okay. Can we take the first one, please?

Raul Sinha, JPMorgan

If I could have two questions, please. Just the first one on Rest of Asia-Pacific, where you had quite a strong performance, there was a small rise in provisions; it looks to have ticked up to about $176 million from a run rate of about $67 million last year. Could you comment on any particular drivers of that rise? Or is that broadly in line with the growth in the balances?

Then I've got a second question on HSBC Finance.

Stuart Gulliver, Group Chief Executive

Okay. Let's just take that one first. Iain?

Iain Mackay, Group Finance Director

Yes. The increase there was driven by a specific charge in Australia for a single credit and, equally, a specific charge related to the impairment of an available for sale debt position elsewhere in Asia Pacific. So, in that respect, it's two specific charges, not driven by any particular underlying trend, but two specific charges with respect to credits.

Raul Sinha, JPMorgan

Right, thanks. And the second one is on HSBC Finance. Ex cards, it looks like the revenues within the division are down something like 28% year on year, excluding the impact of the non-qualifying hedges as well. Am I reading that correct? And is there anything driving that, apart from the balance sheet reduction?

Iain Mackay, Group Finance Director

The balance sheet reduction. The gross yields on that book of business remain fairly strong, but the main driver here is the rundown in the size of the book. And, as you can see, that continues to go very much in line with pace over the course of the last few quarters. So there is nothing out of line with expectations in that regard.

Raul Sinha, JPMorgan

Thank you.

Chris Manners, Morgan Stanley

I just have two questions for you, if I might. The first one was on the cost performance. It actually looked like a very good cost performance, if you ex out the PPI provision in the quarter, getting to about $9.9 billion.

I was just trying to work out how sustainable this run rate is from the lower base. Because presumably, throughout the rest of the year, your GBM comp's going to go down, you take out the cost from the US cards business, add back the bank levy, but you could be at consensus there.

And the second one was just on GMB revenues. Obviously, very strong; plus 10% year on year. You're talking about a satisfactory April. Does that mean that we should expect quite a big down draught in that GBM revenue from the great first quarter? Or could you maybe give us a little bit more color on how things are going? Thanks.

Iain Mackay, Group Finance Director

Yes, I'll gladly take the cost question, Chris. I think your analysis sort of holds water. Clearly, the PPI provision in the first quarter is something that we'll no doubt get a few more questions on. But if you assume that, at some point, as an industry, we get this under wraps over the course of the coming quarters, I think it's a reasonable expectation to see that come back into, hopefully, very, very smaller negligible numbers, going forward.

And, as a consequence of that, you do move the cost in the direction that we clearly want to move the costs. And we believe that that's sustainable now.

When you look at what we've done on sustainable saves over the course of last year, the first quarter of this year,

the team continues to build that pipeline of sustainable saves. And it's very much with a view to moving that cost number on an ongoing underlying run rate basis back towards the $9 billion number.

Now recognizing that, in a Group of this size and complexity, we're probably going to have some volatility in that number from time to time, but recognize that we've got the trend moving in the right direction now.

Stuart Gulliver, Group Chief Executive

And hopefully, we'll be able to demonstrate and give everyone comfort on this fact at next week's strategy day, because, clearly, this is -- what we've focused quite a lot of our efforts on over the last 12 months is to get this cost base under control.

Turning to what satisfactory means for Global Banking and Markets, a couple of background comments and then, I suppose, a little bit of direction. We do not have a substantial equity business. We have a great equity business in Asia-Pacific and quite a modest one in Europe, good one in Middle East and in Latin America.

Therefore, the significant collapse in volumes going through equity trading and ECM has less of an impact on our Global Banking and Markets model than it does on some others.

Again, the decline in volumes of M&A has less of an impact on us than it has on some others. And the DCM volume does have some impact on us, but, again, we don't have a large US domestic DCM business. So some of the macro trends that we all recognize in the industry are more muted in their impact on us than they are on some others.

So what's satisfactory, I suppose, broadly means is -- and that satisfactory comment is actually to the Group, not just Global Banking and Markets, but obviously Global Banking and Markets is a significant part of our performance of the first quarter -- is that April's around where analysts' consensus is for that Global Banking and Markets monthly run rate.

Chris Manners, Morgan Stanley

Okay, perfect. That's really helpful.

Chintan Joshi, Nomura

Two questions from me, please. Firstly, can I follow up on that cost comment? If I back out the PPI and the seasonality in GBM, I get something like a $9.6 billion and you just made a comment that we should think about that heading to $9 billion. Am I correct in understanding that?

And the second question is on BSM. There appear to be a little bit of gains from AFS in there. Could you set expectations for us in terms of what we can think of how 2012 will be?

Stuart Gulliver, Group Chief Executive

Yes, I'll take BSM and just, Iain, elaborate on the costs.

Iain Mackay, Group Finance Director

Yes, I wouldn't read a nice round $9 billion into any comments I say. We're moving these numbers southwards with a view to achieving a sustainable run rate for this business based on the cost-efficiency ratio that we laid out of 48% to 52%, based on what we think are reasonably reliable revenue streams through what is, clearly, fairly volatile operating conditions.

Moving it to the underlying level that you've identified, Chintan, is encouraging in the first instance. There is a healthy pipeline of sustainable saves ahead of us and our intention would be to continue to move it southwards.

But I think, as Stuart mentioned earlier, we'll go into a good deal more detail on this in our strategy day and hopefully provide you with some reassurances as to how we manage this cost base going forward. I wouldn't read a round $9 billion into this number, though.

Stuart Gulliver, Group Chief Executive

Okay, within balance sheet management, there's $397 million of disposals, which relate, primarily, to disposals of gilts where we decided to lighten up on a substantial gilt position that we took some years ago for the obvious reasons that rates or yields look actually quite rich at this level.

So, therefore, you've got, as you rightly point out, about a $1.2 billion for the first quarter and we've previously guided about a $2.5 billion number for BSM. I think

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you could reasonably plug in a $3 billion, but, again, as Iain says, don't go for round numbers.

So what I would suggest is that BSM should be around about $3 billion for the year.

Chintan Joshi, Nomura

Thank you.

Rohith Chandra-Rajan, Barclays Capital

Just a couple of questions really just on the US book. Continuing reductions, they're obviously in the balances which you talked about in relation to revenues earlier. Just wondering if that was the main driver of the quarter-on-quarter fall in the impairment charge there, or if they're -- the degree of seasonality you talk about, tax rebates, etc., I wonder if you could quantify that at all?

And also, any update on the foreclosure process? Thanks.

Iain Mackay, Group Finance Director

Look, as far as the -- I think it's fair to say that you should always read seasonality into the first quarter performance of this portfolio. It's very difficult to quantify, but, as we talked about at the end of the year, what we saw happening in terms of seasonality last year and we saw the year before, we would expect to see again this year. So it has, thus far, played true to form, with a significant downturn in delinquencies.

So again, I think I wouldn't encourage you to carry that seasonality through the next three quarters, and bear in mind the sort of seasonality that we've experienced over the last number of years in this portfolio.

What is encouraging is that it's performed in a manner that's consistent with our understanding of that seasonality, and certainly consistent with what we see coming through the daily and weekly payment runs from the business.

So we have seen delinquency going down. The degree to which that is specifically attributable to people applying their tax refunds to the pay downs of their loans is difficult to say, but I think it's fair to assume that it's significant.

In terms of looking at foreclosure processes, we are back doing foreclosures in all but one state in which we operate. That one state is Jersey, which has a particularly judicial view of managing the foreclosure process.

That being said, there is a significant backlog and this is true for the industry. There is a significant backlog of properties that have moved through to default that now require to be moved through the foreclosure process.

Our focus continues to be trying to take all reasonable measures to keep people in their homes and, when that fails, turning to foreclosures as really the last resort. But in terms of moving that process forward and implementing the remediated actions that are required, progress is sound.

Rohith Chandra-Rajan, Barclays Capital

Okay. Thanks very much.

Tom Rayner, Exane BNP Paribas

After the full-year results, you sounded a little bit less confident of the cost-income target. You mentioned the revenue environment being partly out of your control. It looks as if the environment has improved. I wonder if you could comment firstly on that within GBM.

You've mentioned the BSM, although it does look like you're going to have to have a significantly weaker second, third and fourth quarter to come in line, even on an underlying basis, in line with the guidance, and also whether there's any issues in GBM on the comp ratio, just so we get a sense of the first quarter.

But also, outside of GBM, I'm wondering in terms of margin trends, volume growth, the other drivers on the revenue, has that changed your view on whether the 48% to 52% is a comfortable target by 2013? I just wonder if you could add your thoughts on all of that, please.

Stuart Gulliver, Group Chief Executive

What I would prefer to do, Tom, is to take this in some detail at the strategy day, because what we're going to do at the strategy day is trying to peel back so that you've got some visibility on, for want of a better expression, reliable revenues.

Because within our Global Banking and Markets business, there are many revenue streams that actually are quite reliable, and then there's an element of it that

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is similar to most other global banking and markets businesses. And we need basically to spend quite a bit of time, and Iain and I will dive into this next week to try and help you get to understand this.
The 48% to 52%, I think, has to stay in place because as I shift the business more towards the emerging markets, they have lower cost-efficiency ratios. As we run off the legacy businesses, that helps us to lower cost-efficiency ratios.

And, actually, I do believe that QE will result in inflation at some point in time and interest rates will be higher in the United States and in the UK, for example, at some point in the future, perhaps not by 2013, which, of course, with $1.2 trillion of deposits will drive our net interest margin in a very material way.

Let's not lose sight of the fact that we have a $1.2 trillion deposit base which actually just generates no net interest margin worth talking about for us at the moment, but will do once again.

So I don't think we should back off the 48% to 52%, because there are some fundamental things that mean that this Group should get there.

On GBM specifically, I do think that we've seen market share gains in the foreign exchange line; and you can see this also in a couple of surveys that have come through; Euromoney and Greenwich, and so on.

And we've also gained there by much closer collaboration between Commercial Banking and Global Banking and Markets where we're harvesting our own SME base, which clearly generates a lot of foreign exchange through focus on trade finance and the international network of the Group.

And I think we've also seen in Asia-Pacific market share gain at the expense of some of the European banks who pulled out of the trade finance and structured trade finance area.

But my hope would be that at the strategy day we'll give you better visibility on what are reliable revenues, so that we can try and build across to that piece.

On the cost side, as Iain has gone into some detail already, we absolutely are embarked upon managing the trend of the cost base down in the way we said we would.

Tom Rayner, Exane BNP Paribas

Okay, thanks. And is there a specific margin story there at all? You mentioned market share gains. I'm just wondering if there's been some positive re-pricing opportunities because of maybe European banks pulling back?

Stuart Gulliver, Group Chief Executive

There really isn't. Group margin, overall, is up 1 basis point, or something similar, and there are several moving parts. Margins in Latin America are up dramatically; in Asia, are modestly up; Middle East, modestly up; and Europe are down somewhat, partly because there's obviously competition for deposits as the state-owned banks try and wean themselves off state financing and compete for deposits.

So, overall, it's kind of a mixed bag, but there's definitely volume, if not margin positives, that sit within those Global Banking and Markets numbers.

Tom Rayner, Exane BNP Paribas

Okay. Thanks very much.

Stuart Gulliver, Group Chief Executive

And to one earlier point, this isn't just simply we sat on a bunch of inventory; the LTRO came along and spreads tightened; not at all.

Tom Rayner, Exane BNP Paribas

Okay. Thank you.

Ian Gordon, Investec

Could I just have two, please? Firstly, on the strong insurance performance in Hong Kong, you obviously referenced the favorable market conditions, but can you just add some color on the sustainability of that level of performance?

And secondly, a dull question on tax. Can you just clarify the explanation in the statement for the higher-than-usual tax charge in the period? And I assume that there's no reason to assume anything different from our usual weighted average back of envelope calculations for the tax charge going forward. Thanks.

Iain Mackay, Group Finance Director

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In terms of Hong Kong, I think market conditions, certainly in terms of recovery of the equities markets in Hong Kong in the first quarter, was an important element of the performance with respect to the insurance business there.

In terms of earned premiums as well, that moved up, so there was a very specific focus in Hong Kong on sales effort within the insurance business and that paid off.

Trying to attribute any proportionality to that, which is markets versus which is driven by the sales team, is probably a little bit more difficult that I would want to get into in this call. But I think, overall, you can attribute a fair amount of this to market recovery within the Hong Kong space.

Looking at the tax rate, effective tax rate of 32% for the quarter and you're absolutely right, that's certainly higher than what we guide to of between 19% and 21%. Key factor there is that we took provisions in the current period as it related to prior period tax adjustments, and that's really about the extent of the story.

So we have around the world any number of ongoing discussions with local tax authorities and we take a proactive approach to addressing those issues in close discussion with them, so that's really what this relates to.

Ian Gordon, Investec

Okay. Thanks, Iain.

Chirantan Barua, Sanford Bernstein

A quick question here on Europe. One of the things that I've noticed is that on the personal side, both in residential mortgages and other personal, you've suddenly started accelerating your loan growth out there. Is it in the UK? Or is it a significant change in strategy?

And the second part to that was commercial --

Stuart Gulliver, Group Chief Executive

Yes, sorry. It's very simple, it's UK.

Chirantan Barua, Sanford Bernstein

Okay. And I see that you've been building up your commercial real estate book as well. That's again part of your strategy because many of your peers have actually stepped out of this space.

Iain Mackay, Group Finance Director

No, certainly with respect to UK lending to the SME sector, we have made commitments in terms of what we want to accomplish this year, and we're meeting those commitments. But it's not specifically focused on commercial real estate, which has been a close focus of the Commercial Banking team in terms of managing the quality of that portfolio, which continues to hold up reasonably well in difficult conditions. Okay?

Chirantan Barua, Sanford Bernstein

Thank you.

Iain Mackay, Group Finance Director

But to amplify it very momentarily in your UK mortgage lending, this is not a recent phenomenon. If you go back over the last couple of years, the UK business has progressively built its share of UK mortgage lending.

If you look at market share of new approvals it's just under 15%, and market share of stock is less than 6%. If you compare that to the beginning of last year, it was about 5.3%. So we are growing share, but the LTV in new mortgages continues to be fairly muted at about 55%.

Chirantan Barua, Sanford Bernstein

Thank you.

Ronit Ghose, Citi

Just a couple of questions, first one on Hong Kong. The Commercial Banking profit number has stepped up quite meaningfully quarter on quarter and year on year, and I don't think volumes have. Is there any color you can give us around margins or any other key profit drivers for the CMB in Hong Kong?

Secondly, just to go back to GBM, I know we've talked about it in the other questions but clearly you've had a really good performance in rates and FX in the first

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quarter. I understand about the FX in terms of cross selling, etc. Is there any more color you can give us on rates? Is there any material amount of for bounce-back or recovery revenues in there?

And the final one is just a small techie one. The capital gain on the US Card sale, is there an exact number you can update us on, please?

Iain Mackay, Group Finance Director

You want me to take Commercial Banking in Hong Kong, Stuart?

Stuart Gulliver, Group Chief Executive

Yes, sure.

Iain Mackay, Group Finance Director

Commercial Banking in Hong Kong, you're absolutely right, net interest income is up significantly year over year. That is largely on the growth of the balance sheet over the course of the last 12 to 18 months, which is quite noted.

Also in terms of net fee income, that's grown quite significantly, but this is really a function of the focus and effort between the integration of the Commercial Banking and Global Banking and Markets business, and is perhaps most notable in the foreign exchange product line there.

So the Commercial Banking team in Hong Kong is doing exactly what we asked them to do in terms of managing the margin of the existing book of business, as well as growing their collaboration with the Global Banking and Markets business.

Stuart Gulliver, Group Chief Executive

In the rates and credit space one of the phenomenon that comes about, because of the weaker position that a number of European banks have, is that the debt capital markets will pick up a lot of the burden. So, actually, there is a significant increase in the first three months in the amount of debt capital markets activity. And, obviously, we've spent, I guess actually about 10, 12 years building up a bond capability, so that also sits within those rates and credits numbers. And then yes, there is an element of positions that we held on European sovereigns where spreads have tightened as a result of LTRO.

But, again, I would stress it's not a static set of inventory where spreads have simply tightened in. There are several components in this and, again, at the strategy day we'll try and unpick some of this so you can get a better sense of what's kind of -- I don't want to use the word annuity, but what's a reliable revenue stream within these Global Banking and Markets numbers and what has more volatility attached to it, so you can effectively build, hopefully a better model in terms of valuing these streams.

Iain Mackay, Group Finance Director

On the Cards transaction, the guidance on this front is largely in line with what we've previously given. It's clearly dependent on the closed process around the exact balances that are being transferred as of the date of the transaction, but the pre-tax gain is likely to be in the range of $3 billion.

Ronit Ghose, Citi

$3 billion, thanks. And just quickly on rates and credit, is there any color you can give us on inventory levels today, say, versus a year ago, middle of last year?

Stuart Gulliver, Group Chief Executive

We've broken out our exposure to the peripheral Europeans within the IMS, page 25. So you can see that there's not. If anything they're actually lower.

Iain Mackay, Group Finance Director

They are.

Stuart Gulliver, Group Chief Executive

So we've broken out for you Italy, Spain, Greece, Portugal, etc.

Ronit Ghose, Citi

Right. I was just thinking of generally the credit inventory in general compared to, say, 12 months ago or nine months ago, just given what's happened to credit spreads in Q2.

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Stuart Gulliver, Group Chief Executive

It would be lower. So the inventory in the first quarter, notwithstanding the fact that there's a gain on it, would be lower than the inventory spread previously, because, obviously, as Basel 2.5 kicked in at the end of December we, obviously, did some work in the third and fourth quarter of last year to significantly reduce the inventory.

So this is my point. This is not a static set of positions because the Basel 2.5 RWA jump, which was of the order of $50 billion, which was why the capital Tier 1 dropped to 10.1% at the year end, was actually after mitigation. That mitigation involved reducing the amount of inventory we were holding. So actually this is on a lower inventory than we would have held typically in 2010, 2011.

Ronit Ghose, Citi

Okay, thanks.

Mike Trippitt, Oriel Securities

Two quick questions. Just on the North America run-off portfolio, $200 million loss in Q1, obviously down quite a bit on previous quarters. I was just having a quick look at the Finance Corporation disclosure. It looks like impairments are roughly steady quarter on quarter, so I just wondered if you could just talk us through what else is happening within the run-off in the first quarter?

And then, secondly, just a very quick follow-up on the Cards disposal. Could you just -- I realize the deal hasn't closed yet but could you just remind me what the risk asset reduction is likely to be on that -- on the Card and Retail Services disposal?

Iain Mackay, Group Finance Director

Yes, certainly. Looking at loan impairment charges first of all, if you take the US in total, loan impairment charges are down more than $500 million compared to the same quarter last year. That's driven almost entirely through the CML portfolio and the Cards and Retail Services portfolio, with improving delinquency through the first quarter driven, to a significant degree, by payments from customer tax refunds, which is a normal seasonal effect in the first quarter for this portfolio.

So the loan impairment, a significant part of the improvement in profitability for the US business as a whole and specifically the consumer finance business, is on lower loan impairment charges.

Now what you need to bear in mind as well there are certain US GAAP and IFRS differences between what you read in the US filings and in the IFRS filing, or the IFRS numbers, which are prepared at a Group level. However, on the LIC line, the difference is not there.

As it relates to the Cards transaction, that has, in actual fact, closed. It closed on May 1 and the release of risk weighted assets on that transaction is going to be in the region of $40 billion to $45 billion.

Mike Trippitt, Oriel Securities

Thanks. And can I come back, the loan -- my question really was specifically on the run-off portfolio. That was a $211 million loss in the quarter, which is quite a lot down on the run rate, but what I was looking at is that the impairment within that is much the same. I think if I'm reading this Finance Corporation stuff correctly, it's about a $900 million -- sorry, I'm just trying to think if there was something else going on elsewhere on the --?

Iain Mackay, Group Finance Director

No, the impaired balance is -- the stock of impaired assets is largely consistent, but the charge for loan impairment charges during the quarter is down significantly.

Mike Trippitt, Oriel Securities

My misunderstanding, apologies. Okay.

Iain Mackay, Group Finance Director

That's okay, no problem.

Mike Trippitt, Oriel Securities

Thank you very much.

Michael Helsby, Merrill Lynch

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I've got two quickies, and then just a question on loans. I was just wondering on the PBT reported today if you could just split out for us what the contribution has been from businesses that you've either disposed of, like the Card business, or you've discontinued or announced that you want to dispose of them? So that's question one.

Question two, I was wondering if you could just give us a dollar amount for the PVIF valuation gain that you have referred to in Hong Kong.

And then, finally, loan growth, it looks like, on a constant currency was about 4% annualized in the first quarter. That's if I take out the HFC business.

I was just wondering if you could give us an update, maybe it's something for the strategy day, but if you could just give us an update on how you see risk appetite again and competitive pressures that you're seeing at the moment particularly in your emerging market businesses? Thank you.

Iain Mackay, Group Finance Director

So your first question, gain on sale contribution to the PBT of businesses disposed of during the quarter is less than $200 million and the --

Michael Helsby, Merrill Lynch

Sorry, you misunderstand me. What I said, the -- so the total contribution to the PBT line, not from the gain on sale, but just from the ongoing businesses, so like your Card and Retail is $669 million. So if you add together all the businesses -- presumably that's something that you must look at on a quarterly basis.

Iain Mackay, Group Finance Director

Yes, well that is -- the most significant element of it, by far, in fact the only significant element of it, is disclosed on page 34 of the IMS, Michael. Really, when you look at the other businesses in terms of dispositions they're not significant in the grander scheme of things.

Stuart Gulliver, Group Chief Executive

Michael, the only that -- clearly we understand what you're getting at. The only one that's dilutive is the Cards business.

Michael Helsby, Merrill Lynch

Okay.

Stuart Gulliver, Group Chief Executive

All the others have not been a success for HSBC. And the Cards businesses, as we've discussed this time last year, is not strategically lined up where we want to reposition the growth. But the only one that's dilutive in any material way is Cards.

Michael Helsby, Merrill Lynch

Okay, I hadn't seen page 34, thanks.

Iain Mackay, Group Finance Director

Okay. In terms of PVIF, Michael, we'll dig that out and get back to you. I don't have that one to hand, okay.

Michael Helsby, Merrill Lynch

Okay.

Stuart Gulliver, Group Chief Executive

And then loan growth, yes, we will go into this in some detail next week.

We have got loan growth in Commercial Banking, in the rest of Asia-Pacific, in Latin America, in the UK. We've got growth in Retail Banking and Wealth Management in the UK, in mortgages, which we talked about a little bit earlier.

In Hong Kong the book is more or less flat, but the book has grown really aggressively, as you know, in the last couple of years. So, given the evolving circumstances in that part of the world, we're quite comfortable with actually maintaining what is a very big market share.

And actually you can see the PBT is pretty strong. So that loan growth from a couple of years ago is coming through in very strong net interest margin; PBT in Hong Kong was up 21%, in Latin America it was up substantially as well.

So 11% Latin America, 24% rest of Asia-Pacific, most of that is coming off the big push into Commercial

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Banking that took place over the last couple of years. But we'll go into more detail so you can get some sense as to dynamics.

As I said earlier, there is market share gain that we've taken, certainly in the rest of Asia-Pacific, as a result of some European banks pulling away. And we continue to have clear guidelines to the management on the ground to continue to growth their business.

So in no way shape or form in the emerging markets are we in a situation where we're doing anything other than grow. And revenue in the emerging markets is double digit, PBT is, overall, double digit.

Michael Helsby, Merrill Lynch

Okay, thanks. Look forward to it.

Alastair Ryan, UBS

So just finally, probably flogging this particular dead horse to the end, on credit revenues, if you quantify -- in last year's annual report you gave some quite good disclosures about losses incurred on legacy businesses, legacy portfolios, whether you could give us a sense of the size of that?

And then secondly, just on the cash balance, it's an extraordinary number now. That's obviously a good thing because you can do something with it down the road, but when do you stop growing it and put the money to work? I appreciate the circumstances are particularly difficult at present, but $153 billion is quite a lot of cash on hand.

Stuart Gulliver, Group Chief Executive

It is. So let me talk about the cash balances.

Clearly they've gone up in part because we liquidated a large gilt portfolio, which is the $397 million AFS gain in balance sheet management, and we remain pretty risk averse. And if you dig into this, you'll find that this is very much a European phenomenon.

So balances with central banks are significantly high from our operations in Europe. If you look at Asia-Pacific and North America, they are nothing like the same. So the risk aversion is specific to this part of the world, which, again, you'd expect it to be.

We think that the LTRO has made the inter-bank market even more risky, because we think there are very few unencumbered assets around at other banks. And we're also mindful of depositor preference in certain countries. And, therefore, we do end up with a situation where we're going to have a greater surplus than there are opportunities to deploy it in the eurozone, or in this part of the world, in a way that reflects an appropriate reward for the risk.

Now, to your point, yes, it gives us optionality further on down the road. It gives us tremendous capacity to meet genuine end user client demand at some point. And, of course, at some point in time this resolves itself as growth, at some point, coming through into these economies.

I guess what sits behind the question is, do we at some point, therefore, decide to lift the AD ratio of the Group so that we've got a smaller balance? I don't think so.

I think that we need to be pretty disciplined, because I think one of the great strengths of HSBC remains the fact that we're retail funded and, therefore, the extent to which we have an AD ratio of 74.8% that presents us with $153 billion with central banks, I think, is a sign of strength, and not something we should be tweaking by reducing the deposit side of the balance sheet, which is the only way to deal with it in these type of circumstances.

Iain Mackay, Group Finance Director

Alastair, I don't have the legacy credit information at hand. We'll come back on that, okay.

Alastair Ryan, UBS

Thank you.

Simon Willis, Daniel Stewart & Co

Stuart, two questions for you, if I may, and, in a sense, they do relate to the strategy, and I respect what you say about waiting for next week's strategy day.

The first one is on the cost-income ratio. One of the features over the recent quarters has been upward inflationary pressure on expenses in Asia and emerging markets, and you refer in the statement today to Latin America in that respect, as well as the rest of Asia-Pacific.

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But the expenses performance in Q1 does look particularly good against Q3 and Q4. Is it fair to say that you would feel meaningfully more confident in the outlook for the end '13 48% to 52% range than you would have done as you were going through Q3 and Q4? And I have a second question.

Stuart Gulliver, Group Chief Executive

I think what you can see is that we've started now to make some material progress in terms of sustainable saves. And, as Iain was saying earlier, we're now at a kind of $2 billion annual run rate of sustainable saves. That, if you like, gives us capacity to deal with the headwind of wage price inflation in the emerging markets.

So you've got proof, I think, starting to come out of the fact that we are getting our arms around the cost challenges of HSBC and starting to deliver some significant progress in that regard.

What we'll do on the investor day is to give you more detail on the evolution of cost, but also to try and give you also where we're going to get the sustainable saves, how we're going to manage the cost base, but also to try and give some evidence of what we see as reliable revenues, because obviously there are two elements to this thing.

And what I'm really not prepared to do is to abandon the 48% to 52%, because I do think that this is a bank that has a tremendous emerging market business and I'm shifting the entire focus so that the emerging market business predominates. That, naturally, should have a cost-income ratio below 52%.

Secondly, we will, at some point, see interest rates rise and inevitably QE will lead to higher rates at some point in time. That will generate substantial net interest margins for us on a $1.2 trillion deposit base. And, at the same time, we're seeing reasonable growth in the emerging markets where we have substantial footprint and we're also getting some traction on our costs, which we'll talk in detail about next week.

The problem that's obviously befallen us is we did the strategy day May last year and the eurozone got into extreme difficulty subsequent to that strategy day. But I want to keep the pressure on myself and my colleagues to try and actually get a grip on the cost structure of HSBC. And I do think there are several, as I say, substantive reasons that I've just outlined why we should stick to this 48% to 52%.

Now we clearly have a series of things we can control, and what I was getting at in the third, fourth quarter is, I don't have control over how the eurozone evolves. So things like that I can't control. But the things I can get my arms around, I think that we are evidencing with this first quarter's numbers that we're starting to gain traction.

Simon Willis, Daniel Stewart & Co

Okay, thank you. And the second question relates to investment in China, mainland China, going forward. Until the fairly recent past, you've been limited on the size of the stakes that you can take in Chinese associates, and it seems that the ceiling is going to be lifted to 49%.

Can you give us your thoughts on whether that may change the balance for your investment in mainland China, as between pushing to open new branches and -- on the one hand, and looking to develop in other ways, e.g., raising the stakes in associates, or buying into other available opportunities?

Stuart Gulliver, Group Chief Executive

So, my understanding, actually, is the 49% refers only to securities companies, and joint ventures with securities companies. It does not apply to stakes in banks or insurance companies. So I don't think it would -- from our interpretation of the comments out of China, I don't think it does change our ability to invest, or increase our stakes in the associates.

So, therefore, we will continue to approach China with a two-pronged strategy. One is, obviously, our stakes in Bank of Communications, and the other is to open our own branches. So we'll continue to push a dual track; an investment in BoCom, which is the flagship investment, and opening as many branches as the authorities will allow us to do.

And, as I say, the 49%, our understanding is it's only related to securities companies.

Simon Willis, Daniel Stewart & Co

Yes. Thank you.

Alistair Scarff, Merrill Lynch

Two quick questions, if I may. Looking at the Latin American asset quality story, bit of an uptick there. Is

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this just a natural maturation of the strong growth that you guys took on in recent times? Or is there anything sinister that we should be looking into that? That's question one (multiple speakers).

Stuart Gulliver, Group Chief Executive

Shall I just answer that, Alistair? So look, what's gone on in Latin America is, we obviously had a big push, loan growth in Retail Banking Wealth Management, Commercial Banking, in the last couple of years.

The higher impairments there are a result of volume growth combined with the fact that Brazilian GDP actually fell quite sharply in the second, third quarter of last year. And what you're seeing in our book is no different than what you would see if you looked at Itau or Bradesco or Banco de Brasil.

Now, actually, Brazilian GDP is smartly back up again now, so we don't think there's anything sinister. The collections processes are all in place. This clearly has the kind of vigilant attention that you'd expect it to have. And so I don't think this is anything more than the cycle in an emerging market.

Now, clearly, it's an emerging market that's going to have higher volatility to its cycle than the developed world. And the tick up is to the order of about $200 million, $250 million, on a book of $31 billion.

Alistair Scarff, Merrill Lynch

Understandable. Thanks for the clarification. And secondly, on the similar theme of asset quality, recent numbers out of the Indian banks suggest asset quality may be stabilizing. Given your recent performance in the Indian market, any comments as to how your Indian story is going?

Stuart Gulliver, Group Chief Executive

There's nothing really remarkable. I would point out that Indian numbers are up, year on year. With a little bit of luck we should be adding 20 or 22 branches from the acquisition of Royal Bank of Scotland's Retail Banking operation in India. There's nothing really I would point out that I think certainly has cause for concern for us at the moment.

Remember, the majority of our PBT in India tends to be Global Banking and Markets; and first quarter of this year versus same quarter of last year is up quite smartly.

Alistair Scarff, Merrill Lynch

So no asset -- none of the asset quality concerns which have been affected (multiple speakers)

Iain Mackay, Group Finance Director

No. We've actually been incredibly stable on asset quality, really over the course of the last three to four quarters, Alistair. And in terms of what you see coming through in loan impairment charges in India in the first quarter of 2012, dare I say it is almost negligible.

Alistair Scarff, Merrill Lynch

Excellent. Thanks, gentlemen. See you next week.

Sally Ng, CICC

Just a quick question. Could you share with us the net interest margin in first quarter? And perhaps on an ex-household basis as well, since that book continues to run off.

With the fact that a lot of the central banks in Asia has been cutting policy rates, and the fact that your NIM for the rest of Asia-Pacific increased quite substantially last year, would you think, related to sort of policy rate cuts from some of the Asian central banks, could affect your NIM in Asia, going forward? Thank you.

Iain Mackay, Group Finance Director

Net interest margin for the Group, as Stuart mentioned earlier, was up 1 basis point, at 242. If you look at our Asian operations, net interest margin there for the first quarter, when compared to the previous quarter, was up a couple of basis points as well.

Actually what we've experienced in the second half of last year were policy rate movements upwards, in terms of Australia, India, China; all of which had a reasonably favorable effect on our net interest margin, as well as balance sheet management revenues, in each of those markets.

In North America, yields hold up very, very nicely, actually, in terms of how we fund that business. Our

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funding costs are actually lower, so net interest margin has expanded about 25 basis points over the last quarter, for that reason.

So overall, the Group's net interest margin is holding reasonably solidly, Sally. Where we see a little bit of pressure is in the European operations, and a little bit in the Middle Eastern operations.

Sally Ng, CICC

Right. And with Asian central banks cutting rates, would you be -- and Australian, would you expect the NIM pressure to re-emerge for the rest of Asia Pacific?

Iain Mackay, Group Finance Director

Certainly where we carry a significant deposit base, which is virtually everywhere in the world, then the likelihood of seeing some pressure on the liability side of the balance sheet, with lower central bank rates, I think, is a reasonable expectation. That's a phenomenon that our balance sheet management teams are well attuned to.

Sally Ng, CICC

Right. Just a last question. Hong Kong, its funding cost is coming off quite quickly, because the liquidity for US dollar and Hong Kong dollar has improved. What about the NIM in Hong Kong? Would that more than compensate for the rest of Asia-Pacs?

Iain Mackay, Group Finance Director

Yes, the Hong Kong NIM is holding up perfectly well. In fact, it's expanding ever so slightly, as I mentioned.

Sally Ng, CICC

Okay. Okay, thanks.

Michael Helsby, Merrill Lynch

I get there were two notable items in expenses in the quarter; the PPI and the restructuring. Was there anything else, or is that pretty much it?

Stuart Gulliver, Group Chief Executive

No. It was like $468 million for the customer redress, and about $260 million for the restructuring.

Michael Helsby, Merrill Lynch

Okay. So I just want to try and get a base line for ahead of next week. So your OpEx in Q1 of '11 was $9.4 billion, ex-notable items. Is that the right number I should be thinking of to reconcile your sustainable cost saves of, I think, the $1.2 billion? That is the number I should be thinking of? I think your clean number's $9.6 billion this quarter.

Iain Mackay, Group Finance Director

Yes, let's talk about that in more detail next week, Michael. Hopefully we'll answer your questions in that regard then.

Michael Helsby, Merrill Lynch

Okay. Thanks a lot.

Stuart Gulliver, Group Chief Executive

Okay. Any more?

Operator

There are no questions.

Stuart Gulliver, Group Chief Executive

Okay. I think we'll bring the call to an end. Thank you very much for your interest in HSBC, and for your support. We'll see you all next week. Thank you.

Operator

Thank you, ladies and gentlemen. That concludes the HSBC Holdings plc 2012 Interim Management Statement. You may now disconnect.

Forward-looking statements

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