2012 Interim Results

Presentation to Investors and Analysts

30 July 2012, 11.30 am BST

Operator

Good morning, ladies and gentlemen, and welcome to the investors and analysts conference call for HSBC Holdings plc's 2012 interim results. For your information, this conference is being recorded.

At this time, I will hand the call over to your host, Mr. Douglas Flint, Group Chairman.

Douglas Flint, Group Chairman

Good morning from London and welcome to our 2012 HSBC interim results webcast and conference call. With me is our Group Chief Executive, Stuart Gulliver; and Group Finance Director, Iain Mackay.

In a moment, Stuart will set out the major points of the first half's performance; Iain will talk through the financial detail; and Stuart will then cover the strategic progress made before opening the floor to questions. Stuart, over to you.

Stuart Gulliver, Group Chief Executive

Thank you, Douglas. You'll all have seen the report from the United States Senate Permanent Subcommittee on Investigations, which has been extensively covered in the media, and which has revealed our past shortcomings in relation to compliance with US regulations; including anti-money laundering laws and the Office of Foreign Assets control sanctions.

We said in our annual results for 2011 and 2010 that we have been cooperating closely with US authorities, but the Subcommittee hearing will have been the first time most of you will have seen the detail.

I very much regret HSBC's past failures and I apologize for them. Our controls should have been stronger and more effective.

As you would expect, HSBC has a number of means to discipline people who fall short of our standards, including clawing back bonuses and dismissal, and a number of people have left the Company. But I also want to explain what we're doing to make HSBC more resilient and less likely to see a recurrence of these problems.

When the new leadership team came in, in 2011, we recognized that immediate action was required. First, we changed our organizational structure.

In the past, we were organized along country lines; so over 80 separate businesses. Our new structure, with four global businesses and 10 global functions, plus HSBC Technology and Services, makes it easier to manage and control the firm. Better global integration allows for a coordinated and consistent approach to compliance and to risk.

We've made HSBC simpler. Through our five-filter process, we have announced 36 disposals and closures since the start of 2011, exiting non-strategic markets and selling businesses and non-core investments.

These disposals make the firm more manageable, reduce risk and let us concentrate on our strengths as an internationally connected Bank.

We have also put a sharper focus on compliance and increased our spending on it to over $400 million.

Under our new structure, Group Compliance has authority over all personnel, all over the world. This puts us in a better position to detect and address compliance risk globally.

We're adopting and enforcing adherence to a single regulatory standard globally that is determined by the highest standard we must apply anywhere, and this will typically be US standards.

This means, among other things, that we are maximizing information sharing for risk-management purposes across HSBC to the extent permitted by privacy laws.

We're also applying a globally consistent approach to Know Your Customer regulations and all Group affiliates are, therefore, now required to complete due diligence on any other HSBC affiliate with which they have a correspondent banking relationship.

We're developing a global risk filter, which will standardize which countries are viewed as high risk and

this will become the sixth filter. And we are putting in place a global sanctions policy which will mean that we will be screening for all illicit acts as designated by the Office of Foreign Assets Control in all jurisdictions and in all currencies.

We are committed to doing whatever it takes to make sure that the organization is able to detect and prevent unacceptable behaviour.

Before moving on, please can I draw your attention to the cautionary slide on forward-looking statements, and I'll now turn to the first-half results.

Reported profit before tax was $12.7 billion; up 11% compared to the first half of 2011. Our underlying profit before tax, at $10.6 billion, was down around $400 million, reflecting a number of notable items, including UK customer redress at $1.3 billion and $700 million of provisions for US law enforcement and regulatory matters.

First and foremost, though, the most important thing I want to highlight in these numbers is that we have generated revenue growth. Underlying revenues are up 4%. We have top line revenue growth.

We've also continued to simplify and restructure the business, with 19 transactions announced since January 2012 to sell or dispose of non-strategic businesses and investments, bringing the total since the start of 2011 to 36. These transactions release about $55 billion in risk weighted assets.

These disposals are also making HSBC easier to manage and control and so too is the organizational effectiveness program.

In the first half, we have achieved some $800 million of sustainable saves and we have reinvested them into the business, into business growth and into compliance infrastructure.

Thanks to the execution of the strategy, we're capturing growth. We've increased revenue by 13% in Hong Kong, where GDP only grew by 0.5%; 13% in the rest of Asia Pacific; and 8% in Latin America, again outgrowing GDP growth rates.

The same regions driving the world's economy are also driving our success. This is exactly what we said we wanted to achieve when we launched our strategy back in May 2011.

The Global Banking and Markets has had a strong six months. Underlying revenue rose 10%, and PBT was up 7%. This supports our view that our Global Banking and Markets operating model, with its focus on emerging markets and on financing, is substantially different from our competitors. Its performance in the second quarter in particular compares favorably to others.

This half, we've also seen strong revenue growth in Commercial Banking, which, as I've said before is our heartland. This has been driven by customer lending in Asia during 2011, and this is exactly what we said we'd deliver as part of the strategy.

Our return on average ordinary shareholders' equity was 10.5%. This was down on the same period last year, but that's largely as a result of a higher tax charge. I'll show you later why we think we can still hit the target range of 12% to 15% next year.

And we've also continued to generate capital, strengthening our core Tier 1 ratio to 11.3% from 10.1% at the end of 2011. Earnings per share, at $0.45, were slightly lower than the first half of 2011. That decrease is also largely due to the same higher tax charge.

The reported cost-efficiency ratio was broadly stable, at 57.5%, but with an underlying ratio of 61%. But around 8 percentage points of that 61% relates to notable items, as Iain will explain later.

The geographic spread of our results shows why we're investing in faster growing regions. Asia has been an absolute powerhouse. Profit before tax was up some $670 million in Hong Kong, and $540 million in the rest of Asia Pacific. Together, they accounted for well over two-thirds of total profit before tax. We have grown revenues, controlled costs and expanded margins.

In Latin America, profits are up 3%, as we grew revenues and reduced costs. In the Middle East, too, profits are up.

By contrast, Europe is disappointing, and that's not so much because of the eurozone, but because of customer redress provisions, and that comes across particularly clearly in the UK figures. This half, we've made a provision of $1.3 billion. This includes $1 billion in relation to payment protection insurance, and around $240 million for interest rate protection products.

The North American figure reflects provisions for certain US law enforcement and regulatory matters, but, on the positive side, our North American loan impairment charges have reduced, reflecting declining

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balances in run-off portfolios, and a stabilization in delinquency rates. Our Canadian business continued to perform very well, and which, I would remind you, is the future model for our US business.

Iain will now take you through the financials in more detail. Iain?

Iain Mackay, Group Finance Director

Thanks, Stuart. You'll have seen these reported numbers, with profit before tax at $12.7 billion, which is up compared to the first six months of 2011.

We've accomplished a great deal during these six months, with some significant disposals, and the gains on these affect the reported numbers, along with movements in fair value on own debt, non-qualifying hedges, and notable items.

On an underlying basis, profit before tax was $10.6 billion; down around $400 million, that's 3%, on the first half of 2011.

Revenue was up 4% on the back of growth in Global Banking and Markets and Commercial Banking, particularly in Asia. We are delivering growth in our key markets, where we've focused our investment in line with the strategy. This was offset by higher operating expenses, reflecting significant notable items in the first half, and I've analyzed these costs later.

Meanwhile, on an underlying basis, loan impairment charges were broadly stable compared to the first half of last year.

Turning to revenues, 4% underlying growth has been driven by those areas and markets in which we've been investing; in Commercial Banking, for example, where we lent more in Asia. We have achieved a growth in incremental revenues of 16% from the further integration of Commercial Banking and Global Banking and Markets.

Global Banking and Markets revenues are also up, with growth in rates, foreign exchange, payments and cash management, and balance sheet management, again validating our business model.

Retail Banking and Wealth Management has increased revenues by 5% in faster growing regions. In part, this was because of rising interest rates in certain countries, demonstrating the leverage effect of our deposit base.

Underlying costs were $1.9 billion higher than the first half of 2011. This reflected $2.6 billion of notable items, and these include a provision of $700 million in respect of certain US law enforcement and regulatory matters, UK customer redress provisions of $1.3 billion, compared to $611 million for the first half of 2011. Quarter 1 provisions for PPI were $468 million, and quarter 2 provisions, $537 million.

Restructuring costs were $563 million, compared to $477 million for the same period last year.

In the first half of the year, we've achieved sustainable cost savings of some $800 million. These have broadly been reinvested into those businesses which we identified as priorities in our strategy, and into compliance infrastructure.

In aggregate, since the start of 2011, we've now achieved $1.7 billion of sustainable savings, or $2.7 billion on an annualized basis. We're now above the bottom end of our target range of $2.5 billion to $3.5 billion savings, and the underlying cost-efficiency ratio has deteriorated from 57.7% in the first half of 2011 to 61%. But bear in mind that this includes notable items, equivalent to 7.9 percentage points on the underlying cost-efficiency ratio.

This slide shows that operating expenses are broadly stable for the past six quarters, excluding notable items, with a slight decrease between the first and second quarters in 2012.

The number of people working for HSBC has fallen by 27,000 since the first quarter of 2011. Some 17,500 of these are accounted for through the organizational effectiveness program, and the rest largely through disposals.

Turning to credit quality, loan impairment charges are stable on an underlying basis. There has been a notable reduction in the North America run-off portfolio.

The figures for Retail Banking and Wealth Management in Europe have improved, thanks to better delinquency and collections performance. The increase in the rest of Asia Pacific includes impairment of a small number of specific corporate exposures, primarily in Australia.

Meanwhile, impairment charges have increased in Latin America, particularly in Brazil, reflecting higher consumer lending and delinquency rates.

Finally, as Stuart said, the Group continues to display capital strength. Core Tier 1 capital at the end of June

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stands at 11.3%, as against 10.8% at the end of June 2011. That increase is largely accounted for by the gain on sale and a reduction in risk weighted assets from strategic disposals.

We're well positioned with respect to Basel III. Based on our strengths, we expect to be a good position throughout the transition to full implementation 2019.

Now let me hand you back to Stuart.

Stuart Gulliver

Thanks, Iain. Our strategy has set the context for everything we're discussing today and we updated you all in May on the considerable progress that we've made.

In the light of that progress, we reaffirmed our 2013 targets and this slide shows the path towards our targeted return on equity between 12% and 15%. Now evidently at 10.5% we have some way to go, but that 12% to 15% target is supported a target return on risk weighted assets of between 2.1% and 2.7%, based on a core Tier 1 ratio of 10.5%.

Now I know obviously that target returns will be impacted by evolving regulatory requirements and return on risk weighted assets targets will be reviewed accordingly, but, on an underlying basis, this half we have achieved 1.8%. Excluding the US Consumer Finance, Cards and Global Banking Markets legacy businesses, we're actually at 2.3%, bearing in mind that that included the negative impact of $2.6 billion of notable items in costs.

On a regional basis, you can see that Hong Kong, the rest of Asia Pacific and the Middle East are well above 2.1%. Latin America is not far below it and both Europe and North America are clearly well below it. These regions are where the notable items and the legacy portfolios are hitting hardest, which is why we're restructuring the firm aggressively in these areas.

Now this slide is a quick reminder of the geographic spread before we look at the contribution of different businesses in more detail.

Commercial Banking delivered a strong performance. Global Banking and Markets was the most profitable of the businesses for this half, with revenue and profits up. Retail Banking and Wealth Management was affected by customer redress and the run off of the US Portfolio. And now let's to take each in turn.

At our Investor Day I described Commercial Banking as the flywheel that drives the whole firm, with an international network giving a level of connectivity that few other international banks can match. That gives us a strong and sustainable competitive advantage.

Our investment in faster growing regions is reflected in the 12% revenue growth Commercial Banking saw in these markets. We generated higher revenues from lending activities and higher deposit balances that reflected growth in our payments and cash management business in the rest of Asia Pacific.

Revenues from Global Trade and Receivables Finance increased strongly, up 14%, driven by our operations in Hong Kong up 12%, the rest of Asia Pacific up 18% and Latin America up 28% as we continue to capitalize on our position as the world's leading trade finance bank.

Revenue increased by 16% from the sale of Global Banking and Markets products, notably foreign exchange products, to our Commercial Banking customers. And that success encouraged us in May to increase our target from $1 billion to $2 billion in incremental revenues from the further integration of Global businesses over the medium term.

Our Commercial Banking business has a very competitive cost position, with an underlying cost-efficiency ratio of 46.7%, which includes the impact of customer redress and restructuring costs at 2 percentage points. Moreover, the work we're doing to deliver a globally consistent operating model will enable us to drive further improvement in this cost-efficiency ratio.

Our Global Banking and Markets business, in a period of uncertainty, had a strong six months with revenues up around 10%. Foreign exchange recorded strong revenues, driven by robust client activity and increased market volatility, which led to an improved trading environment. Rates revenue rose, reflecting strong risk management of our books and their geographic diversification.

We also generated higher revenue from PCM with an increase in our customer account balances. And balance sheet management reported higher gains on the disposal of available-for-sale debt securities. Foreign exchange, PCM and trade are consistent and growing contributors to overall business and Group performance, with revenues up first half on first half and second quarter on second quarter.

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This reflects that GBM is a customer-driven business, with a strong international network of clients servicing international trade.

Now at this point let me say, as I know you'll ask, that there are a number of ongoing investigations into past submissions of Libor and Euribor interest rates. As a panel member, we've been asked to submit information and are cooperating with various authorities around the world. It's too early, though, to say what the outcome of those investigations will be and it will be inappropriate to comment further.

Meanwhile, for Retail Banking and Wealth Management, it's been six months of significant transition as we progress the reshaping of this business globally to improve returns. We've completed sale of the cards business and the upstate New York branches. We've completed other disposals and closures, including retail operations in Thailand, Poland, Russia, Georgia and the insurance businesses in Argentina.

And we also continue to work towards completing previously-announced sales or closures of various Retail Banking and Wealth Management businesses in Canada, Costa Rica, El Salvador, Honduras, Japan, Columbia, Peru, Uruguay and Paraguay, and the general insurance businesses in Mexico, Hong Kong, Singapore and Ireland.

Alongside this unprecedented level of disposals, we've continued to build our business in faster growing regions. However, revenue pressures remain in Europe. As a result, we sought to reduce costs and have succeeded in doing so, though results have been adversely affected customer redress costs in the UK and other notable items.

Market conditions have remained challenging for wealth managers and deposit spreads remain under pressure, but we retain our target of $4 billion of additional revenues in the medium term. Because we start from a strong customer base, including 4.3 million premier customers, we seek to achieve the target through investing in Wealth Management infrastructure and capabilities to generate revenue growth in key product areas, including life insurance and investment services.

And in the first half we have demonstrated our ability to grow business in life insurance products, primarily in Hong Kong and in Latin America. And our global Asset Management funds under management have recorded a net inflow of $13 billion over the same period.

To sum up overall, the first half of 2012 has seen us make substantial and encouraging progress in key areas; increasing revenues, especially in Asia; continued progress against our strategy, making HSBC easier to manage and to control; further sustainable cost savings and much improved capital strength.

Looking ahead, economic conditions in Europe and other Western economies will continue to be subdued. Our assumption is that the European leaders will take the necessary measures to preserve the euro. But, even so, we expect the eurozone's economy to contract this year. In the US we anticipate sub-par growth this year and next.

We also continue to believe that emerging markets will grow at a brisker pace. China will play an important role in this phenomenon and we remain confident of a soft landing in China where its leader's readiness to stimulate the economy means that growth is likely to exceed 8% over the full year.

We'll now be very happy to take your questions. And first our operator will explain the procedure and introduce our first question. Operator?

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2012 Interim Results

Questions & Answers

30 July 2012, 11.30 am BST

Alastair Ryan, UBS

Two things, if I may. First, whether the Mansion House speech and the White Paper at the end of June have given you enough clarity to start using some of what's now a very strong capital base and that $150 billion of cash on hand that you've built up?

And second, within GBM, clearly a very good BSM figure, whether I could invite you to update your guidance on that?

And secondly, on the $50 billion of RWAs in the legacy portfolios, how quickly we should anticipate those going away. I know there's a value versus hanging around trade-off, but clearly you've got a P&L to absorb exit costs on what's a fairly material drag on that division. Thanks.

Stuart Gulliver

On the White Paper, I think you can see that we've briskly grown our loan book in the UK, in both SMEs and in terms of UK mortgage lending. So we have an 11% share of new mortgages in the first half of this year versus the 6% overall market share and our lending to SMEs is also moving up briskly year on year.

So you can see capital deployment taking place within the UK, but obviously that $150 billion represents a capacity that is clearly not fully used because we would be running at a much lower number. But it doesn't really reflect a -- what it reflects, to be honest, Alastair, is a risk aversion towards other banks rather than a risk aversion to lending to businesses general.

That risk aversion to lending to other banks comes about because the interbank market is a clean market and there are very few unencumbered assets now amongst weaker banks, partly exaggerated by, or amplified by, LTRO and deposit of preference in certain countries.

So, therefore, we end up with a very large deposit base and an imbalance between our risk appetite and the amount of money we have to deploy.

So in terms of White Papers and the market settling down, yes, we have capacity to lend to corporate, but I wouldn't look at that whole $150 billion because, by definition, that's part of our liquidity and a large chunk of that won't eventually be lent into illiquid assets. But you can see growth in balance sheet and in lending in the UK in the first half versus last year in all of the numbers.

The thing we would say on the White Paper is -- generally speaking we obviously would support better regulation and the whole reform agenda.

Actually we completely recognize the UK's going to pursue ring fencing. It will be a drag on the position of the UK in global markets, but we think the White Paper was constructed for us. It was particularly helpful in terms of the definition of PLAC and the fact that it may not be necessary to apply PLAC to our non-UK operations. And we're working on the assumption that this will go through and we will need to create a ring-fenced and non-ring-fenced bank.

As to the United States RWAs of $50 billion, we've done a bit of work. We've had BlackRock in to look at the books. And the disposals of those are, as you say, a mathematical equation as, indeed, they are for the SIVs and conduits.

I think that you need to look at this run off over a couple of years. I don't think it's going to be shorter than that, unless we see a strong recovery in the markets, which I don't foresee at this moment in time.

I don't know whether, Iain, you might want to add anything in terms of timetables.

Iain Mackay

No, and certainly also what remains tied up in risk weighted assets and the CML portfolio's about $130 billion. And, as Stuart mentioned, we've done a lot of work in terms of preparing to try and accelerate the exit of that through dispositions.

That work's going reasonably well. Hopefully, we'll be able to give you a little bit more information as we get into third and fourth quarters. But the intent is clear that we recognize that we've got the capital and the income statement to support that. So the focus is finding transactions which make some economic sense to us.

Stuart Gulliver

But the process, both for the book in the United States and the SIVs and conduits here in the UK, has started and teams of people are in place and the work streams are live.

Alastair Ryan

Thank you. And on the BSM?

Stuart Gulliver

On the BSM, yes, I think that probably guidance in the $3.4 billion to $3.8 billion type of range for the full year.

Alastair Ryan

Thanks very much indeed.

Chintan Joshi, Nomura

My first question is on your costs. Clearly, down the line, cost development has been quite good. I'm wondering about half-on-half cost developments on an underlying basis. In the past, you've said that you want to avoid seasonal blips in second half. So should we expect somewhat even distribution of costs in H2 relative to H1?

And I have another question on ROE.

Iain Mackay

Chintan, let me take your first question on the costs.

If you take a look at the slide on page 11, I think that probably best describes to you what we're trying to do here. Our focus is very much is driving some productivity in our cost base.

We've realized significant sustainable saves. You saw the second half of last year, what we were able to do. We've got a very robust pipeline of sustainable saves, both for the remainder of this year and into next year that we are going to deliver against.

So the focus is on driving that stability within the cost base and the predictability within that cost base.

It goes without saying that we've got notable items, which are significant. It would really nice to work through those over the course of the next few quarters and stop talking about them. But the focus here is clear. And what we accomplished in the second half of 2011 will be a focus of attention for the second half of 2012.

Chintan Joshi

So should I take it that you're trying to manage the business at a run rate of something like $9 billion on an underlying basis?

Iain Mackay

We're trying to manage the business towards positive jaws --

Stuart Gulliver

Which we have got on an underlying basis. 8.7% positive jaws for the first half.

Iain Mackay

And, in terms of the overall costs, the focus is on achieving the sustainable saves that we've set out and obtaining that target around the cost-efficiency ratio of 48% to 52%. And, therefore, our actions on a month-by-month, quarter-by-quarter basis will be dictated by what we need to do to accomplish that.

Chintan Joshi

Understood, thank you. And my question on ROE is you stated that you hoped to achieve your targeted ROE next year. Would that be on a stated basis or on an adjusted basis? And if it is the latter, then what adjustments would you make?

Iain Mackay

Well I think, again, I'd guide you to the chart that we've got around -- I think it's page 17, which guides you to what we've got the propensity to do in existing businesses and recognizing that we've got some fairly

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significant restructuring to do, and are doing, in European and US businesses.

The number that we've shown you for the first half is on a reported basis. That's how ROE goes. And that's the basis on which we would intend to continue to deliver ROE numbers.

But, clearly, there are significant items that come through and we'll provide you within information about those that you can make the necessary adjustments yourself. But we're going to deliver ROE on a reported basis.

Chintan Joshi

Thank you.

Raul Sinha, JPMorgan

Can I have two, please? Just the first one on revenues. It's difficult to look at quarter-on-quarter revenues, but it does look like Q2, at the Group level overall, was a touch weaker, probably driven by FX.

Now, in the past, you've talked about something like a 60%/40% split, half on half, on revenues due to seasonality. Should we expect that to continue this year? Or do you think the Q2 performance means that we get less seasonality this year?

Iain Mackay

I think, in terms of giving you a little bit more insight in terms of quarterly numbers, Raul, if you look in the appendix to the slide pack that we've put out, that gives you a little bit more guidance, particularly as it relates to Global Banking and Markets on the management view of net operating income. So, hopefully, that will help you.

Certainly, there was real strength within the rates business in the first quarter of the year, because you saw tightening in European spreads.

But, notwithstanding some widening and more stress in the second quarter, you saw the FX business, the payments cash management business, balance sheet management continuing to perform very strongly in Global Banking and Markets, as well as real strength coming through the Commercial Banking business, particularly in Asia and Latin America.

So I think Stuart's comments there around the sort of growth we've been able to build and the revenue line, in fairly challenging economic conditions, not only in Europe and the US but more widely, is encouraging. So I think we'll probably leave the information at that level just now.

Stuart Gulliver

I'll guess just to add a couple of things, the 60%/40% tended to be Global Markets anyway, not RBW and CMB.

And then, as Iain says, GDP growth in Hong Kong was 0.5%, but our PBT was up double digit. The rest of Asia Pacific, GDP, on average, is 4% to 5%. Our PBT's up double digit. In trade, we've got a 14% growth in trade-related revenues, which is more than twice the rate of growth for global trade.

So, although the economic conditions second half may look weaker, we appear to be picking up market share because we're growing at a faster rate than GDP in a number of places.

Raul Sinha

Good. Just second question, just on costs. If you look at the breakdown of staff reductions that you've provided, very helpfully, over the last six months, it does look like the reduction in FTE is a lot higher in emerging markets than in Europe, for example, leaving the US aside for a minute.

Is there something in that chart that is not representative of the businesses? Or is that a conscious decision in terms of where the costs are?

Iain Mackay

What's your question? Is it about headcount or is it about costs?

Raul Sinha

It's about headcounts. On slide 11, you show the regional FTEs and the reduction in regional FTEs. So we can see in Asia Pacific, for example, FTEs are almost down 5,000. In Europe, they're only down 1,800. It does look like your FTE reductions are much more in emerging markets than in Europe.

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Stuart Gulliver

Don't forget, we've sold a lot of businesses in the emerging markets.

Raul Sinha

Right. So, on an adjusted base --

Stuart Gulliver

So all of that big list of RBWM and general insurance and so on, all comes out of the emerging markets piece, or comes out of Asia Pacific. And then we've also sold a bunch of businesses in Latin America and so on.

Raul Sinha

Okay. So there's nothing to read into that.

Stuart Gulliver

No, there is honestly isn't. Everything's done off the five filters. It's very objective. It's incredibly well documented as well because, obviously, we need to get the regulators comfortable in every place. So there's nothing you should think about strategically.

Actually, the interesting data from a strategic developed world emerging market point of view is actually where the risk weighted assets now sit.

If you look at developed markets, the high-end risk weighted assets were $658 billion in the fourth quarter of '11. And now the low is actually at the end of June this year, which is $586 billion. So $658 billion down to $586 billion.

In emerging markets, the low was the first quarter of '11, $490 billion, and it's now at the high, $573 billion, again, at the end of June this year.

So we've taken EM from $490 billion up to $573 billion and the developed markets down from $658 billion to $586 billion.

So if you want evidence of the shift to emerging markets, it's probably better shown in risk weighted assets.

Raul Sinha

Understood. Thanks very much.

Stuart Gulliver

Next, please.

Chris Manners, Morgan Stanley

I just had a couple of questions for you. Firstly, it was on Hong Kong. It looked like a strong performance there, with net interest income outpacing loan growth. And I was just quite interested to see what your outlook was for the margin there. I understand, obviously, the loan-to-deposit ratio and the competition should potentially build a benefit.

And secondly, just on the Asian trade finance piece. The 14% growth, you're talking about in trade finance-related revenues; again, pretty impressive. I was just wondering about your outlook for that and, particularly, just to understand what the competitors were doing.

I understand that the European banks are likely to withdraw after the Q1 boost they'd have from the LTRO that they're going backwards again. I was wondering if you could comment on that.

Iain Mackay

I'll take the first question. When we look at margin in Hong Kong, it's actually the net interest margin has remained remarkably stable over the last number of quarters.

Now you'll remember that we had a little bit of expansion on HIBOR, which certainly helped a little bit on both the deposits and the asset side in Hong Kong.

But, overall, the margins have remained remarkably stable, both on the asset and the liability side, over the course of the last four or five quarters, actually, in the Hong Kong market.

Stuart Gulliver

The trade story's good. Trade revenues are up, actually, about 16% in faster growing regions and 12%, actually, in the developed markets. And you'll remember there's an Oliver Wyman survey that said that of bank finance

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trade, we did actually the largest share of any bank. And that, I think, is continuing to play to our strengths.

So the trade finance revenues have actually grown in the emerging markets about three times the rate of growth of world trade.

And it's actually even true coming out of the UK here. We've financed exports of more than GBP1.8 billion from the UK to the key emerging markets of China and India. And we think that gives us about one-quarter of all the UK exports to those markets, which itself is up about 28% on the first half of '11.

So I think that there is evidence in these numbers of what you're reaching to, which is, are we able to pick up market share as some of the European banks disappear?

And I think that the evidence I would point to is both in these trade numbers, but also in the fact that both in the rest of Asia Pacific and in Hong Kong, we're growing our business at a faster rate than GDP; a multiply faster rate than, actually, GDP plus inflation in those markets.

So I think there is evidence, actually, of taking market share, which is why I think our outlook is modestly positive, actually, for the second half.

Chris Manners

Perfect, that's really helpful. Sorry, Iain, could I just follow up there on margin points? So are you sort of indicating they're expected to stay stable as well?

Iain Mackay

It's been stable thus far. There's nothing that we can see in terms of development in the short term that would suggest otherwise. But I'm not a soothsayer on that one.

Chris Manners

No, fair enough. Thank you. Thanks, Stuart.

Rohith Chandra-Rajan, Barclays

If I could have a couple as well, please. The first one's just on the cost saves. So the save -- the run rate savings reported today at $2.7 billion, up from $2 billion at the end of last quarter. I'm just wondering if there was any update or if that's in line with your expectations for a $3.1 billion run rate for FY '12?

Iain Mackay

Run that one past me again, sorry.

Rohith Chandra-Rajan

So the run rate on cost savings at the moment is $2.7 billion, up from $2 billion last quarter. And I think you said at the Strategy Day the expectation for the full-year run rate is $3.1 billion. Just wondering if there's any change to that?

Iain Mackay

Look, in terms of where we're headed is absolutely in line with the targets we set at Strategy Day and reaffirmed this year. So we've got $2.5 billion to $3.5 billion. We're above the bottom end of that range. Clearly we're halfway through a three-year program, so we've got a good deal more to do.

Stuart Gulliver

But I think you can see we've got traction and our arms round this cost problem, and the underlying costs are evolving and the cost savings are evolving as we said they would.

Rohith Chandra-Rajan

Okay, so no change either in the -- obviously good progress in terms of achieving the top end of the target range and no change in your expectation on the phasing, given experience to date.

Iain Mackay

Not really, no.

Stuart Gulliver

No.

Rohith Chandra-Rajan

Okay. And then secondly was just to understand the impact of the -- particularly the cards business going forward. You highlighted the cost-income ratio underlying 53%. Based on the disclosure you give on

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page 29, that looks like about 53.9% if we exclude the cards business. Just wanted to check that was the case?

And also if you could just add a bit of color in terms of NIM progression, excluding the cards business. So it looks down 30 basis points on the reported numbers, half on half, but I'd just like to understand what the exclusion of the cards business does to those trends? Thanks.

Iain Mackay

Well, let me take the second one first. So in terms of NIM in the North American business, there is a fairly substantial drop off from the first quarter to the second quarter of this year.

That is very much largely accounted for by the fact that we sold and closed the sale in the cards business on May 1. So we were missing two months worth of margin from the cards business. So there is a fairly significant and, as signaled, expected impact around the disposition of the cards business.

In terms of what you see on page 28 and 29, I think that's the information that we've provided and that's correct, page 38 sorry.

Stuart Gulliver

There's just one other point, if I can just jump in. One of the things that you'll see on net interest margin, you've got to also balance it out for why those LICs are also holding in quite well.

We're trying to redirect the firm away from high-risk unsecured lending into more frankly secured higher quality lending. It will, by definition, have a lower net interest margin or spread.

But what we then would expect to see is hopefully we keep more of it, actually, getting to the bottom line, because LICs should be less, assuming that we've improved the quality of the loan book. So you've got to look at this alongside the evolution of the LIC trend.

Rohith Chandra-Rajan

Okay, so it's looking at risk adjusted margin?

Stuart Gulliver

Yes, precisely.

Rohith Chandra-Rajan

Okay. Thanks very much.

Cormac Leech, Liberum

Just a quick question on the balance sheet management. Just following on the earlier question, I think you guided that the full year you were expecting to see about $3.4 billion to $3.8 billion and that implies, I think, about $1.2 billion to $1.6 billion in the second half. Just wondering what, if any, gains on disposals you may be assuming in those numbers? Thanks.

Stuart Gulliver

I'm not assuming any gains on disposals in those numbers. That's why they're set the way they are. What I'm also, slightly, in giving you a range is, assuming that there is a risk that UK interest rates go to the zero bound at some point in the second half of the year and that's part of the reason why -- explains the lower end of that range.

Cormac Leech

Okay, that's very helpful. And then just looking into next year, if you could stay where they are currently and you don't have any disposal gains, would you be able to give us some guidance where you think balance sheet management revenues might settle?

Stuart Gulliver

I think we're getting soothsayer-ish again at this point in time. I don't think I want to give guidance that far out. We can do it again at the third quarter.

Cormac Leech

Okay, all right. Thanks.

Ronit Ghose, Citi

Just a couple of questions. Your Asian businesses have clearly done very well in the first half of the year and what really stood out for me was the rest of the Asia Pacific, the cost-income ratios, I think, the second quarter were 47%. Are there any material one-offs in

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that cost number? Or is this now a steady cruising speed for you?

And, by contrast, in Latin American, Brazil, unless I'm missing anything, seems to have seen quite big deposit outflows. The headline number in dollars, US dollars, was down 20% in the first half and, just backing out the currency move, it looks like it's down 10% in local currency. Is there any color you can give us around that? Am I missing any one-offs or has there been a material deposit outflow?

And I've got a follow on, on PPI.

Stuart Gulliver

Okay, on terms of the cost-efficiency ratio for rest of Asia Pacific, that is probably the cruising run rate.

Iain Mackay

There's a little bit of restructuring cost in there but it's not material. And there is ongoing work there in terms of organization affecting this program, but I think it's a reasonable reflection.

Ronit Ghose

On Brazil?

Stuart Gulliver

Actually, what it literally is, is we've issued more securities in Brazil because, actually, it's cheaper to fund in the wholesale market than to take customer deposits. So there is a change, you're absolutely correct, but it's actually down to a deliberate AML strategy.

Ronit Ghose

And so we'd assume, what, they'd be an outflow of corporate deposits or --?

Stuart Gulliver

Yes. The type of deposits that we'd re-price are likely to be PCM, wholesale type of deposits, as opposed to your sticky RBWM ones.

Ronit Ghose

Right, okay. And the final question I had was on PPI. There's a bigger provision here than I'd expected.

Just looking at the disclosure given at the back of your release, I think page 248, 249, it looks like the claims to date, relative to provisions taken since the first half of last year, it's about a 43% ratio of claims to provisions, which looks a lot lower than the other UK banks have reported, i.e. you've got a lot more provisions than claims.

I'm just wondering to what extent the second quarter is a kitchen sinking, not kitchen sinking but looks like you are taking for the next six months, 12 months already?

Iain Mackay

I think on that front, what is fair to say is that we've taken a view, probably, around the longer emergence of claims. So we've -- I think the coverage that we're looking at is approximately 12 months' to 13 months' worth of coverage, based on the current rate of incoming claims, both through our own outgoing mailing as well as those coming through the claims management companies.

I think that probably compares fairly favorably with those of some of our competitors, where they're looking at probably three months' to five months' worth of coverage within the overall provisions that exist.

I think what is fair to say is that we've seen a higher level of incoming claims than we had anticipated, certainly when we start looking at this issue around this time last year. And that level of incoming claims has remained at a relatively high level, when we would have expected it to start tailing off by this point.

Ronit Ghose

And, just to clarify, the 12 months to 13 months, are you using the current run rate in the second quarter? Or is that a modeled assumption for them?

Iain Mackay

It's a combination of both. It's run rate informing, obviously, what we expect, but we've built some assumptions in around when we would expect to see that current inflow of claims to tail off.

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Ronit Ghose
Okay, thanks. That's clear.

Chirantan Barua, Sanford Bernstein

Two questions, the first one's on A-Pac. A couple of things. A-Pac, you'd laid out a strategy of $1 billion in India, Singapore and Malaysia and Indonesia combined. Could you comment on what's the progress there and when are we going to see those numbers?

And second is on A-Pac impairments. Those impairments have gone up. You've alluded to something in Australia and India, so if you could give a little more color or if there are risky markets that you see out there.

And I have one on money laundering.

Stuart Gulliver

Okay, on the bad debt provisions, they're specific to credit, so they're idiosyncratic.

Chirantan Barua

And what about PBT numbers in the market?

Iain Mackay

Right, one second. I think if you go to page 73 of the interim report it will give you some guidance on where we are at the half year.

If you look at India, we've got $515 million PBT for the first six months. If you look at mainland China, excluding associates, so our own bank in China, that's $454 million at the half year. Add Singapore and Malaysia together, well Singapore is $335 million, Malaysia is $288 million.

Stuart Gulliver

And Indonesia is $175 million.

Chirantan Barua

And do you see the progress there in Malaysia and Indonesia continuing onto the second half of the year? Or do you see a slowdown in some of those markets?

Stuart Gulliver

No, I think that progress will continue in the second half of the year. As I've indicated before, I think we're taking market share off other foreign banks. So Malaysia, Indonesia and Singapore combined are sitting comfortable halfway to the $1 billion. So is India and China; just a little bit short. So I think there's progress on all of those endeavors.

Chirantan Barua

Thanks. And on money laundering, the $700 million number, could you give us some color on how did you arrive at that number? And when do you see the likely timing for the ruling?

Stuart Gulliver

The timing is completely at the discretion of the Department of Justice, so we can give you no further color on that. Remember it's the Department of Justice, together with the OCC and Fed, that decide on penalties not the PSI.

And this is our best estimate, based on the information we have today, but, as we've indicated, the actual number could be materially higher than the provision that we've taken.

Chirantan Barua

Thank you.

Stuart Gulliver

Next, please.

Christopher Wheeler, Mediobanca

Three questions, the first one on Retail Banking and Wealth Management. You've obviously been very active, as you said you would be at the Investor Day last year, in terms of disposing of businesses and streamlining RBWM.

How far are you through that process now? Is it 60%, 70% or even more before you start to just actually obviously generate the returns organically from the business? That's the first question.

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The second one, rather conversely to that one, is on Private Wealth Management or Private Banking. There seem to be a number of quite large wealth management businesses coming lose at the moment, it's clearly an area which you like, but is it an area where you are looking at acquisitions? Or is it still one where you would prefer to grow organically?

And then, finally, just a question on, obviously, your sixth filter. You clearly have done a lot of work since, unfortunately, a number of issues have come to light. Could you perhaps just give us a clue as to whether you feel that the worst of those issues is now behind you?

I know these things keep popping out from the left field, but is there anything else that's really concerning you which may come back as another notable item over the next 18 months? Thank you.

Stuart Gulliver

Everything we're concerned about is in note 25, which is the legal disclosure. So there's nothing that's not in that, that we're aware of today.

Christopher Wheeler

Okay. That's useful.

Stuart Gulliver

As for acquisitions in Private Banking, I think the answer's no.

We need to reform, and this is what Krishna Patel has gone in to do, our Private Bank to ensure that some of the issues that arose there, in terms of the type of clients whose tax affairs have also caused us embarrassment after the data theft, are again, brought into the type of business that we wish to conduct.

You may have heard me say earlier, one of the disadvantages of making acquisitions is, of course, you buy everybody else's KYC standards, which may not be up to your own.

And, if you look around at the various problems, legacy problems, we have, they're mostly acquisitions; Bital in Mexico; household foreclosures and the big bad debts; tax evasion; Republic National Bank of New York. So I don't think you'll see us buying large books of private banking business.

What you'll see Krishna Patel, who's running the Private Bank for us, doing is making our existing Private Bank fit for purpose.

It is an important business for us. You've seen part of the strategy is to focus on wealth and the faster rate of wealth creation in the emerging markets, so it's absolutely a business that's core and central to us. But I don't think it's logical for us to be adding fresh portfolios to what we currently have.

And then in terms of RBWM, how far are we through it, I think that the RBWM disposals, we've got a little bit more to do on life insurance, and then I think most of the disposals in RBWM will have been announced.

There's probably three or four more still to come, but, in terms of progress through, I think most of this stuff is announced. There's possibly -- so, in terms of your percentage way through, we're maybe 60%, 70% of the way through.

Christopher Wheeler

Thanks very much, gentlemen. Appreciate it.

Arturo de Frias, Santander

Two questions, please; one on capital versus growth and another one on GBM.

From your slide on potential impact from Basel III, slide 14, I think it is, you arrive to a fully phased in Basel III world with a 10.3% core Tier 1 ratio, which is probably the minimum that you would like to have.

And that makes me think if, for the next few years, we have to think about an ROE in the region of 11%, 12%, 13%, along those lines, and you are going to spend close to half that, or you are going to distribute close to half that, you are going to be generating internally in the region of 5%, 6% capital per annum.

Are my numbers correct, first of all? Do you think on those numbers the same way?

And do you think that's enough to fund growth for HSBC? Because as HSBC sells their unwanted, or non-core areas, obviously what is left should be growing more. So I wonder whether 6% internal capital generation is going to be enough for HSBC for the next, let's say, two to three years.

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And then a question on GBM. You have also a very useful disclosure on slide 21, looking at the return on risk weighted assets of GBM excluding the legacy credit portfolio.

You're talking about 2.9%, this is pre-tax, obviously, 2.9% return on risk weighted assets, but that is still -- after tax, we are talking about 2% return on risk weighted assets, which is well above most, if not all, your competitors. Do you think this 2% RoRWA is sustainable in the medium term? Thank you.

Iain Mackay

So if I take the first question around capital. Bear in mind that the target that we set out in Strategy Day was to maintain a core Tier 1 of 9.5% to 10.5%, throughout the transition to full Basel III implementation, so throughout the transition process. We're sitting at 11.3% at the end of June.

We would expect to generate capital through ongoing business operations through the remainder of this year. So we'd expect to see that capital ratio, based on everything that we know now, to be a little bit stronger at the end of the year, but recognize also that in 2013, we get about 100 basis points or so knocked straight off that through the implementation of certain aspects of Basel III.

So we would fully expect an appropriate Tier 1 ratio to be sitting somewhere in the range of 9.5% to 10.5%, probably at the higher end of that, through the transition process.

That will be achieved through a number of the mitigating actions that we've described previously. It's the continued rundown of the CML portfolio. Before the first half of this year, it was the disposition of the cards business, which we've now delivered against, and that delivered some 60 basis points of benefit to our core Tier 1 ratio.

So we'll continue to deliver against the mitigating actions that we've got out there, as well as the ongoing capacity to generate significant profit from ongoing operations. So I think, in terms of our capital generative ability, we've got few doubts there under current operating conditions.

The other thing to bear in mind is that, through the disposition of the cards business and a strongly capitalized North American businesses, we have significant capital surpluses there.

Now, we recognize that the likelihood of being able to reallocate that capital to other parts of the business will be limited over the course of the next 18, 24 or so months to ensure, from a regulator's perspective, that we've addressed absolutely the shortcomings that have been identified through a number of regulatory actions over the course of the last couple of years.

But, as we work through those, we would absolutely expect to be able to reallocate some of that capital away from the US business with the approval of our regulators, once we've met those requirements.

So I think on a capital front, we're very happy with where we sit at the moment.

Stuart Gulliver

In Global Banking and Markets, yes, I do think the 2% is actually sustainable.

When we analyze the revenues that are at risk, because they're involved in structured derivative products that get disadvantaged by Basel 2.5, CRD4 or, indeed, Volcker Rule Dodd-Frank, it's only 14% of revenues.

So, actually, the majority of this Global Banking and Markets business really is dependent upon GDP growth in the emerging markets and the growing connectivity between the developed world and the emerging markets.

It's a good strong debt capital markets and foreign exchange business. It's a traded liquid markets business. And I think that, therefore, this is something that we've tried to explain, it's a very different business and revenue makeup than some of our competitors.

So yes, I do think that we can hit the 2% post-tax. So I think that that 2% number post-tax is sustainable.

Arturo de Frias

Okay. Thank you very much.

Stuart Gulliver

Okay. We've got time for one last one and then we're out of time.

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Tom Rayner, BNP Paribas

Can I have a last two, is that okay?

Stuart Gulliver

Yes, that's okay, Tom.

Tom Rayner

Thanks, Stuart. Just the first was just really on the revenue again. It sounds, just from some of the textual comments, that there's still some benefit coming through the numbers from the very fast volume growth you saw in the first half of last year. I think it then slowed down a bit in the second half.

And I see that the loan growth constant currency in the first half of this year is running at about 7% annualized. I'm just wondering, given what you said about the mix change, is this enough to be consistent with the underlying revenue growth you saw in the first half, so the 4%? Is that consistent with what you're seeing in terms of volume growth?

And I just have a second question on the money laundering, please.

Stuart Gulliver

It is consistent. I think your analysis is spot on. There was a big, as you know, pushup to catch up in 2010/2011, certainly 2011, that is driving, in CMB in particular, the net interest margin that you're seeing captured.

And I think that the loan growth that we've seen so far is consistent with holding that through into the second half. And, as I say, there's a definite market share phenomenon going on as well.

Tom Rayner

Okay, thanks. And just finally, just back on the $700 million, I don't know if you can, but in terms of your methodology, just coming up with that figure. I know it's based on all the information you have, but have you looked at total transactions and tried to compare what other banks may have paid when they've been in a similar position?

Stuart Gulliver

Yes, we have.

Tom Rayner

And $700 million is a number that you would hope covers all eventualities. I know you can't be sure about that, but --

Stuart Gulliver

What I would actually say, Tom, is we've analyzed what other banks have paid for similar situations and we then exercised our own judgment. But, remember, this is completely the decision of the Department of Justice. So that's why we said specifically that the actual number could be materially higher.

Iain Mackay

And we have gone back and analyzed our transactions in terms of a look back at historical operations as they relate to OFAC sanctions and, again, that's some of what has informed how we've built this.

Tom Rayner

Okay. Okay, thanks very much for that.

Stuart Gulliver

Okay, thank you. Thanks very much, operator.

Operator

Thank you, ladies and gentlemen. That concludes the HSBC Holdings plc interim report call. You may now disconnect.

Forward-looking statements

This conference call and subsequent discussion may contain certain forward looking statements with respect to the financial condition, results of operations and business of the Group. These forward-looking statements represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Additional detailed information concerning important factors that could cause actual results to differ materially is available in the HSBC Holdings plc 2012 Interim Management Statement. Past performance cannot be relied on as a guide to future performance.

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