Edited Transcript

Interim Results 2014

Presentation to Investors and Analysts

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Corporate participants
Douglas Flint, Group Chairman
Stuart Gulliver, Group Chief Executive
Iain Mackay, Group Finance Director

HSBC

Douglas Flint, Group Chairman

Before we start, I'd like to say a word on behalf of the Board. HSBC produced a suitably well balanced financial performance in the first half of the year against a backdrop of continuing low interest rates and reduced financial market volumes. This was achieved while continuing to invest significant time and resources in reshaping the Group to meet the heightened and evolving expectations of our regulators, and of the communities we serve.

Notwithstanding the challenges before us, I am optimistic that our business model has further potential, and that we have the leadership and human resources throughout the firm to make the most of that potential.

I'll now hand over to Stuart to talk about the context around results, before Iain takes a more detailed look at performance.

Stuart Gulliver, Group Chief Executive

Thanks, Douglas. The key points of the results that we're announcing today are as follows.

Reported profit before tax was $12.3 billion; $1.7 billion lower than the equivalent period in 2013, as last year's first half benefited from higher gains from disposals and reclassifications, principally with respect to Hang Seng Bank's investment in Industrial Bank.

Underlying profit before tax was $12.6 billion, which was $0.5 billion lower than the prior year; and that was affected by a number of significant items.

Commercial Banking underlying revenue grew by 6%, with a very good performance in Asia. And we increased our market share in key product areas in Global Banking and Markets, although our Markets business was affected by low market volatility and client activity, in line with the rest of the industry.

Underlying revenue, excluding significant items, was broadly unchanged in principal Retail Banking and Wealth Management, and we continue to generate capital in order to build our capital base, grow the business, and deliver a progressive dividend. And our capital position remains strong. Our CRD IV end point basis common equity Tier 1 ratio improved to 11.3% compared with the year-end position of 10.9%.

Before I hand over to Iain to cover the half-year numbers in detail, I want to quickly set out the backdrop of our strategy.

The turn of the year marked the start of the next phase of our strategy following the strong progress of the first three years. Between 2011 and 2013, we remodeled the Group to refocus the business, simplify and globalize the organization, and grow revenue. This meant selling or exiting non-strategic businesses, reducing risk in our ongoing businesses, and running down our legacy portfolios.

While we have foregone a substantial amount of revenue through this process, we have created a more coherent, logical and stronger bank with a solid platform for growth. We can already see clear evidence of this through considerably lower loan impairment charges and continuing cost discipline. And what's more, it's enabled us to add $34 billion of shareholders equity over the last three years, as well as to declare an additional $25 billion of dividends over the same period.

It's important to note that excluding underlying adjustments and significant items, we've actually increased our revenue by $3.8 billion over the first three years of our strategy. This is in spite of the disposals and a reduced revenue contribution of $1.4 billion from the US run-off portfolio, $0.7 billion from legacy credit, $1 billion from balance sheet management, and the continued adverse effect of low interest rates since the financial crisis. Our business grew by $6.9 billion over this period, demonstrating our ability to replace revenue organically.

Over the next three years, we'll continue to invest in the higher growth areas of our business centered on our unique international network. This network is HSBC's biggest competitive advantage. Developed over nearly 150 years, it is highly distinctive and difficult to replicate. It sits absolutely at the heart of our strategy which capitalizes on the growth of global trade and capital flows and economic development in developing markets.

The Group today is present in 74 countries and territories and all of the top 15 countries by GDP. Our network covers nearly 90% of global trade flows, and sits on both sides of every one of the top 15 trade corridors in the world, nine of which have our priority markets at both ends.

HSBC is also present in 70% of the world's top 200 cities, 50% of which are in our priority markets. We're therefore extremely well positioned to grow revenue as trade and capital flows accelerate.

We've already been able to improve our market position in a number of product areas. Payments and cash management, global trade and receivables finance, foreign exchange and capital financing are all growth products where we are already strong, and plays to the benefits of our global network and our universal banking model.

You can see from the chart on the right that since 2011, we've increased our market share in all four areas on the back of targeted investment, the strength of our network, and increased collaboration between our global businesses. We expect the revenue opportunity from these product areas to continue to grow, and have positioned our business to capture an increasing share of each.

Our investment priorities for the three-year period ending in 2016 focus on the areas we started to develop in the first phase of our strategy, and any product areas that we are growing and in which HSBC has improved market positions.

The changes we've made since 2011 strongly increase our ability to capture greater market share in these areas. In particular, we aim to reinforce our leading position in trade finance, to deliver improved client coverage of product and payments and cash management, increase foreign exchange collaboration across our global businesses, and renew the capabilities of our electronic distribution platform and strengthen our leading position in renminbi services.

Our investment in these products is supported by investment in countries that bridge trading capital flows such as Germany, the United States and Mainland China, and large city clusters that contain deep international revenue pools. We believe this investment will lead to growth in profits, and increased dividends for our shareholders, and we are pursuing these alongside our equal priorities to implement our global standards program and streamline our processes and procedures.

Iain will now take you through the numbers reflecting our performance in the first half of this year.

Iain Mackay, Group Finance Director

Thanks, Stuart. I'm going to take you through some of the financial highlights and then go into more detail on revenue, costs, loan impairment charges and capital.

For the first half, the reported profit before tax was $12.3 billion, compared to $14.1 billion in the prior-year period. Underlying profit before tax was $12.6 billion compared with $13 billion in the first half of 2013. This decline was mainly due to significant items.

Looking at some key metrics, the reported return on average ordinary shareholders' equity was 10.7% compared to a target range of 12% to 15%. Our cost efficiency ratio is 58.6%. The advances to deposits ratio 74%, slightly higher than the end of the year. And our common equity Tier 1 capital ratio on an endpoint basis was 11.3%, comfortably above our target and reflecting a strong capital position.

This next slide shows the reconciliation between reported and underlying profit before tax. It adjusts for movements on fair value of our own debt, key transactions on our operating results, and foreign currency translation differences. Additionally, we've identified a number of significant items included in the underlying profit before tax which impact the financial performance of the business. I'll talk about these in more detail in the next slide.

A key point here is that the total reduction of $1.7 billion in reported profit before tax compared to the first half of 2013 was due to disposal gains, reclassifications and significant items.

Included in underlying profit before tax are a number of significant items which are linked to restructuring and repositioning of the Group, have an element of recurring volatility, relate to customer redress and litigation, and include a provision in relation to Consumer Credit Act in the UK.

The overall lower level of significant items in the first half of 2014 is a key factor driving lower underlying revenue compared to the comparable prior-year period, accounting for a total of $1.3 billion of the $1.4 billion reduction in underlying revenue.

You'll find more details by region and by global business in the data pack on our investor relations website.

This next slide shows the profit contribution of each region after underlying adjustments and excluding significant items. As you can see, compared with the first half of 2013, we grew profits in four out of five regions.

In Asia, higher profits were driven by revenue growth in Hong Kong and Mainland China, reflecting growth in balance sheet management income, increased term lending and higher customer deposits. This more than offset increased costs to support business growth and investments in risk and compliance.

In Middle East and North Africa, the increase in profit was driven by higher revenue, reflecting increased fee income in Global Banking and Markets, together with increased associate income following a strong performance from the Saudi British Bank.

In Latin America, against a backdrop of weak economic activity, profit increased as lower loan impairment charges, primarily in Brazil, and higher revenue, mainly in Argentina, more than offset higher costs from union-agreed salary increases and inflationary pressures.

In Europe, higher profits were driven by our home market of the UK, from lower loan impairment charges, notably in Commercial Banking, partly offset by higher costs.

By contrast, North America was down, primarily due to lower revenue in Global Banking and Markets, and in the US run-off portfolio in Retail Banking and Wealth Management. These were partly offset by lower loan impairment charges also in the US run-off portfolio, and lower costs from decreased staff levels and additional sustainable savings.

This next slide shows the profit contribution of each global business separating underlying adjustments and significant items. You can see that the increase in profit before tax was driven mainly by good performance from Commercial Banking, most notably in Asia and in the UK. Global Banking and Markets was affected by the subdued market conditions, particularly in Markets which have also impacted the rest of the industry.

Despite this, we delivered a robust performance in the first half of 2014; profit before tax down 5% on an underlying basis, excluding significant items. This was enabled through revenue growth and payments in cash management, credit and equities, while rates revenue was broadly unchanged in the period. In addition, there were significantly higher releases of credit risk provisions.

This demonstrates the benefit of our differentiated business model, with its diverse range of products, clients and regions.

Retail Banking and Wealth Management was down as a reduction in loan impairment charges, notably in the US consumer mortgage lending portfolio, was more than offset by lower revenues from the US run off, together with increased costs from inflation, risk and compliance investments, and the UK financial services compensation scheme levy, mainly in our principal business.

Global Private Banking continued to be affected by the managed reduction in client assets due to repositioning.

Taking a closer look at the main themes in revenue and costs, this slide shows revenue adjusted for underlying and significant items. Overall revenue is broadly unchanged as growth in Commercial Banking was offset by declines in Retail Banking and Wealth Management, and Global Banking Markets.

Running through each of the global business drivers, in principal Retail Banking and Wealth Management, revenue was broadly unchanged, with a reduction in personal lending revenue mostly offset by higher income from current accounts, savings and deposits.

Revenue in Retail Banking Wealth Management US run-off portfolio was down $303 million following loan sales and lower average balances. We grew revenue in Commercial Banking by $445 million, or 6%, driven by average lending and deposit growth in Asia and higher average deposit balances and wider lending spreads in the UK. This revenue growth was spread across our home and priority markets, highlighting the strength of the network.

In Global Banking and Markets, excluding legacy credit, revenue declined by $394 million, of which $153 million was from balance sheet management. The first half of 2013 included higher gains from the repositioning of the portfolio for risk management purposes.

In Markets, revenue fell by 9% compared with the first half of 2013, mainly due to lower foreign exchange income, which was affected by lower market volatility and reduced client activity.

By contrast, our rates business was broadly in line with the prior year, and revenue rose in credit.

Our equities business had strong revenue growth, notwithstanding the non recurrence of revaluation gains recorded in the prior-year period. This highlights the good work we've done to reposition the business to capture increased client activity.

In other businesses, capital financing revenue was broadly unchanged. However, we increased our market share in debt and equity capital markets, mergers and acquisitions, and lending. Cost revenue was higher in legacy principal investments and payments and cash management.

On operating expenses, again separating out the underlying adjustments and significant items, we saw an increase of $756 million, or 4%. Looking at the key drivers, principal Retail Bank and Wealth Management was up $463 million, mainly in Latin America and Asia. This was driven by higher staff costs reflecting inflationary pressures, and increased investments in risk and compliance, together with $121 million levy for the UK Financial Services Compensation Scheme.

Commercial Banking was up by $221 million, again driven by Latin America and Asia due to inflation and investment and staff to support revenue growth. Against this, the continued run-off of the US portfolio led to $148 million of lower costs.

To be clear, when we talk about investment in people, process and technology, we're referring to some of the investment priorities that Stuart outlined at the start of this call. These include payments in cash management, global trade and receivables finance, and renminbi services, in addition to risk and compliance, including global standards, which remains essential to the future which remains essential for the future of the firm.

We will deliver further cost savings as we continue to simplify and streamline our businesses, processes and procedures in line with the strategy.

On loan impairment charges, underlying loan impairment charges were down from $3 billion to $1.8 billion, with the ratio of loan impairment charges to average gross loans and advances to customers falling to 36 basis points from 61 in the prior-year period. This was mainly due to declines in Europe, North America and Latin America.

Europe was down $623 million, reflecting lower specific and collective impairments, mainly in Commercial Banking, together with higher net releases of credit risk provisions and available for sale asset backed securities in Global Banking and Markets.

North America was $274 million lower, reflecting reduced levels of delinquency and new impaired loans in the US run-off portfolio, and lower lending balances from the continued run-off and loan sales.

Latin America was $260 million lower, primarily in Brazil, reflecting changes to the impairment model, and assumption and revisions for restructured loans which occurred in the prior year. This was partly offset by refinements to the impairment model on non-restructured loans in the first half of this year.

With respect to capital, our common equity Tier 1 transitional ratio improved to 11.2% from 10.8% at the beginning of the year, and our end point common equity Tier 1 ratio increased to 11.3% from 10.9%, reflecting capital generation and the benefit of higher fourth interim scrip take-up.

RWAs increased, predominantly from the application of lower -- of loss given default floors and organic growth in Europe and Asia, offset by a reduction in legacy portfolios.

Regulatory uncertainty remains. As yet, it's not possible to determine the Group's common equity Tier 1 future requirements and the interplay of various capital buffers without clear guidance from the regulators. However, we place great importance in the Group's ability to maintain and grow distributions to our investors derived from business profit generation.

To ensure that we remain able to do this on an ongoing basis, it remains our intention to maintain a buffer above regulatory minimum requirements.

Turning to drivers of returns, off a much stronger capital base, we delivered an annualized return on equity of 10.7%, down from 12% in the comparable period. This was primarily due to lower net gains on disposals, notably Industrial Bank, and the impact of significant items.

Return on equity for 2013 was 9.2%, and bear in mind the second half of each year is significantly influenced by the UK bank levy and seasonality in revenue terms, particularly in Global Banking and Markets.

Returns in the first half of 2014 exceeded our cost of equity, estimated at 10%, and represent continued progress towards profitability targets as evidenced by improving return on risk-weighted assets in our businesses.

Our current pre-tax return on risk-weighted assets stands at 2.1% on a reported and an underlying basis, and 2.3% excluding legacy businesses. We provide a breakdown of the Group underlying return on risk-weighted assets by global business and split out the legacy portfolios for Global Banking Markets and Retail Bank and Wealth Management.

I'll now hand back to Stuart.

Stuart Gulliver

Thanks, Iain. So a quick word on business outlook. We remain broadly positive about the economic outlook for the majority of our home and priority markets, and the UK in particular should maintain a firm recovery.

We've slightly increased our forecast for Mainland China GDP growth to 7.5% for 2014, and we expect Hong Kong to benefit from export growth in the second half of the year. Growth in Latin America, however, remained muted.

Our Middle East business continues to perform well, although we're mindful of regional uncertainties. We believe that interest rates could start to rise as early as the fourth quarter of 2014 in the UK and the first half of 2015 in the USA, which has positive implications for our revenues, given the size of our commercial surplus.

We remain well placed to meet future capital requirements, to continue to deliver an attractive total shareholder return, and to establish HSBC as the world's leading international bank.

Now I'm very happy to take questions. The operator will explain the procedure and introduce the first question.

Questions and Answers

Raul Sinha, JPMorgan

Can I have two, please? Firstly, on the Commercial Bank, obviously, it seems to be the main driver of the fact that your revenues have stabilized now. I would have thought the first half would represent the biggest challenge in terms of the margin drag in this business.

Clearly, NII is fairly up. It's up 1%, despite your loans being up 7%. Do you think as we get into the second half of the year this business should start to show better growth just from the fact that spreads might actually be better year on year in the second half?

That's my first question.

The second one is on Hong Kong. I was wondering if you could -- if I could invite you to elaborate a little bit on your comments on why you expect Hong Kong to have a better second half than first. Is this because your GDP estimates are better in China or in the US, or is there any specific pickup you're seeing in any of your businesses there?

Thank you very much.

Stuart Gulliver

Okay. So you're right. In Commercial Banking, PBT was up 15%/16% on an underlying basis, revenues up 6%, customer lending balances up 7%. And we saw some reduction in margins coming from a repositioning of the book in Brazil towards MMEs, which are of a better credit risk and therefore borrow at a tighter spread, and some further -- so that's a voluntary act, a de-risking act, so it should also result obviously in lower loan impairment charges going forward.

And at the same time, there was some increased competition around the trade finance and receivables piece in Asia. But margins in the UK, we've seen some increases in spreads in the UK, some increases in spreads in Europe.

So I think your general comment that have we seen the worst of spread compression, what we can see actually is that it's not getting any worse. There isn't actually a clear sign of it getting any better either though, to be honest. I've got a graph in front of me that shows it's clearly bottomed, but it's not going back up.

Raul Sinha

But the year-on-year comparison in the second half should look better, shouldn't it?

Stuart Gulliver

Better. Yes, it should. Yes, because the delta reduction in the second half of last year should not be as great as in the second half of this year.

So on Hong Kong, I think our view is simply that, yes, we think the economy should grow about 2.9/3% second half. I think we expect -- remember, in the first half, there were slower tourist arrivals coming into Hong Kong. We think that that will correct in the second half. Inflation's remained low. And if we're right about the China data picking up into the second half, that should actually feed through into Hong Kong in the second half.

So it really comes from a view that -- and, actually, I think it's shared actually by the Hong Kong Government that the second half should see improved economic conditions which should lead, as I said in my remarks, to higher export growth in the second half.

Raul Sinha

So it is China then; it's not something specific (multiple speakers?

Stuart Gulliver

No, it's China. And actually, one needs to get used to the fact that Hong Kong is a second order impact of China.

Raul Sinha

Okay. Thank you.

Stuart Gulliver

Be it tourism, be it trade. Thank you. Next one, please.

Chira Barua, Sanford C. Bernstein

Stuart, in your closing remarks, you mentioned on interest rate sensitivity. I know you have some numbers, mechanical numbers on the different currency blocks. It would be great if you could just walk us through -- especially the sterling block, the Hong Kong rates have delivered; that is well known -- where do you get it from, both on the asset and the liabilities side.

That is question number 1.

And the second on cost. Going to slide 15 on the deck Iain mentioned the different blocks. So risk compliance up significantly in terms of cost. How long will we see the drag from risk compliance? Is it going to go on for the next two/three years?

That was my second question.

Stuart Gulliver

Okay. There's a reasonably detailed disclosure on page 163 about the impact of net interest income and what happens in the various blocks of currency. There's very little I can add to that.

If you look at the overall -- what I can actually say is this. If you look at the overall number of $979 million which comes about on $25 million a quarter for a full year, yes? Two things about it. That $979 million is a product of about a $2 billion gain in Commercial Banking and Retail Banking and Wealth Management, less about a $500 million negative in balance sheet management, and about a $500 million negative in Global Markets, which should itself be offset by a $500 million improvement in trading income, because that's the financing of trading positions. So that's how you get to the net of plus $1 billion. Clearly, if rates go up quicker, it's a higher number.

And that's probably as much disclosure as I'm allowed to give at this moment.

But the $979 million consists of $2 billion up in CMB and RBWM, minus $1 billion-- consisting of $0.5 billion in balance sheet management and $0.5 billion in Markets. But the $0.5 billion in Markets should itself be offset by a $0.5 billion gain coming through the mark-to-market line of things like rates and credit.

Chira Barua

That is very helpful.

Stuart Gulliver

And then on the costs --

Iain Mackay

Yes, on costs. Certainly, when you look at the step-up in the compliance expenditure over the course of the last few quarters, if I just take the second half of 2013 and the first half of 2014, our compliance spend is at about $750 million to $800 million for the 12-month period, and that has stepped up around $200 million, $150 million to $200 million compared to a year before that.

So I think there is a continued investment within compliance. This is not -- we don't believe it's an inexorable climb northwards for the next two to three years. But certainly, I think we continue to see, whether it's the cost relating to the monitor, whether it's the cost relating to implementation of systems around financial crime, and whether it's the investment and training to support some of these compliance requirements, I don't think it's necessarily the case that we've reached a normal, stabilized run rate. But we've certainly have been investing in this now for the better part of the last three years, and I think we're likely to see stability, if not in the course of the next few months, certainly in the course of the next few quarters.

Chira Barua

And, Iain, is there an opportunity in RBWM for the US run-off portfolio -- because there also costs have gone up -- as the portfolio winds down in the next few years?

Iain Mackay

I'm sorry. Say that again, please.

Chira Barua

So in the run-off portfolio in the US, is there an offsetting kind of cost opportunity there? Or is that a sticky cost base, at least for the next one year?

Iain Mackay

Well, no. As the portfolio runs off, there's obviously the opportunity to flow that through from the cost base from a servicing perspective. And actually, as you've seen in the US overall, we've reduced the cost base very significantly quarter over quarter, half over half, and that is reflected both with the reshaping of the US banking business, as well as the run-down of the consumer and mortgage lending portfolio.

So as the revenue comes off, there is absolutely an opportunity, and the team is realizing economies on the cost base. However, unfortunately, there is a servicing requirement that is maintained, even for a de minimis portfolio. So although the revenue is coming off at quite a good clip, we are getting costs off.

And a small snippet: For the first time in many years, the finance company in the US actually generated a profit for the first six months of the year.

Chira Barua

Thank you.

Stuart Gulliver

But that does not mean we're going back into that business.

Chira Barua

No definitely not

Iain Mackay

Full steam ahead in sub-prime lending. Thanks very much Next one, please.

Chintan Joshi, Nomura

Can I have one and then a couple of follow-ups? On BoCom, clearly, our value in use gone up to $14.6 billion; has allowed you to book associate income. Can you explain why this number has gone up? I think the conversation at the full-year stage, it had – you know I didn't expect this number to move up. But clearly, there are things happening there.

And also, if BoCom was to issue, say, preference shares or equity in a way that dilutes your stake, how would that impact your value in use calculation?

The two follow-ups, shall I take them now or after the answer?

Iain Mackay

So why don't we give you the answer on BoCom to start with?

Chintan Joshi

Sure.

Iain Mackay

There's a lot of detail on the value in use sitting in Note 21 to the financial statements, Chintan. If you want to take a look at that, it gives you some of the dynamics within the calculation.

But value in use is not a static number. So we update this a quarter in arrears based on the financial performance of BoCom, based on other factors around gross assumptions like the discount rate, the loss rate, the terminal growth rate.

But the thing that influences, certainly over the first six months of this year most significantly, value in use is one, dividends received from BoCom; and, two, the financial performance of BoCom over the preceding six-month period. And we are on a 90-day lag in terms of access to detailed financial information about BoCom and how that's reflected in our financials.

So as the carrying value moves in our recognition of profits, dividends and so on and so forth from an accounting perspective, so the value in use is also impacted. It's not a one-for-one correlation, but it is also impacted.

So we'll continue on a quarterly basis to do a value in use analysis, compare that to the carrying-value; and at the point at which the carrying value overhauls the value in use, that is the point at which we will no longer be recognizing -- on a gross basis recognizing the income from BoCom on ongoing.

Now you may recall that when we talked about this at the end of last year, we did say that we expected that overhaul to take place around the middle of the year, possibly in the second half of the year, and that's still our best estimate of when that's likely to occur.

But the VIU model is a dynamic model, and there's more detail on this on page 255 in the financials, if you want to dig into the detail on it, Chintan.

Chintan Joshi

Thanks. And if they issue pref shares or equity, how do you think it impacts your -- how you account for it?

Iain Mackay

Well, it dilutes our position, so that again would be reflected both in carrying value and in value in use.

Chintan Joshi

Understood. The follow-up was on the [Asia] outlook and costs. Could you --? You talked about H2 outlook for Hong Kong being strong. I would presume you feel similarly about the [valuation] franchise. But also, if you could differentiate between retail versus wholesale there; if you feel there's a difference between the outlooks within retail versus wholesale.

And then on costs, just following up. There's been a step-up in the run rate, excluding significant items. I was just wondering what your thoughts are. Have we re-based after -- for many quarters of pretty good performance there? Are we moving up slightly on the run rate there?

Thanks.

Stuart Gulliver

So I'll take the retail versus wholesale, and then Iain can take the one on the costs.

I don't think that's the way to look at it. I think the reality is that the outlook is determined by the shape -- or the way we will profit from the outlook is determined by the shape of our business in a particular country.

So in places where we are both retail and wholesale, your question may be valid, i.e., Hong Kong, but I think it will benefit Hong Kong across all of the customer groups.

In other countries we don't have an equal split of PBT between the various customer groups. In a place like India, the majority of our PBT comes from our Global Banking and Markets business. So therefore, it isn't relevant to say whether GDP growth benefits retail or benefits wholesale. For us, GDP growth will manifest itself through Global Banking and Markets.

So as I say, I think the honest -- the flick-back to your answer is you need to look at the shape of our business in a country, and that's where you'll see those GDP growth numbers come through.

Chintan Joshi

Thanks.

Iain Mackay

I think on the cost front, Chintan, I don't really think we've per se seen a significant step-up. There's a couple of items within the cost base for the first half, and obviously the Financial Services Compensation Scheme of $121 million is a significant factor.

The UK customer redress charges are moving in the right direction for us, so I think there's further opportunity there. And certainly again, from a sustainable saves perspective, we generated over $500 million in the first half of the year. We've got a significant target set for the team in the second half of the year, and on an ongoing basis.

So I don't think at this stage we're ready at all to give up in terms of the broad run-rate that we've talked about within the cost base. And I think we saw some -- clearly some inflationary pressures, and just a step-up in investment in certainly the compliance space in the first half of the year.

And going back to one of the earlier answers, that's not an inexorable climb northwards, in our view. It is investment that we are making now to create a stable basis for compliance capability across financial crime and regulatory compliance in the round.

Chintan Joshi

Thanks. That's encouraging. Thank you.

Stuart Gulliver

Thanks very much. Next one, please.

Alastair Ryan, BoA ML

Thank you good afternoon and thank you for giving us Hong Kong back in the numbers.

Stuart Gulliver

Absolutely.

Alastair Ryan

If I -- I might have something I probably won't get anywhere with, but I'll ask it anyway. So 40 basis -- (multiple speakers). Thank you.

40 basis points of common equity Tier 1 in the quarter. Now going back -- sympathize, as everyone does on the call with the unpredictability of the Bank of England's demands, but you did give us some reasonable clarity in the Q1 numbers of a probable requirement of around 10 points for -- in the 10s for where you're going to be.

The FPC said there's no countercyclical buffer for a long time to come. There's no sector capital add-ons coming, so you're well in place on the leverage ratio.

How concrete could I invite you to be on the level of confidence of not keeping building that number and handing some of it back instead? Because it certainly feels like your opportunity to step up distributions, one way or another would very much be there?

Iain Mackay

Yes. No, I think, Alastair, what hopefully we provided some clarity around in the first quarter was Pillar 2A, as opposed to anything else, of which 56% of that is covered within common equity Tier 1. And that represented 87/90 basis points on top of the 9.50%. And the 9.50% is made up of the 4.5% of common equity core -- common equity Tier 1 base requirement plus the countercyclical buffer plus the G-SIFI buffer.

Now -- not the countercyclical, the -- sorry, the capital conservation buffer.

I'm glad you've heard there's no countercyclical buffer. We haven't heard about that recently, so we've obviously been missing something in that respect. There's not a countercyclical buffer for the moment. But I don't think they've definitively said there's not going to be one.

And I think the other thing which perhaps has been thrown a little bit into the melting pot in the course of the last few weeks is the consultation paper that's come out on the leverage ratio, which the variant that the PRA is at least consulting on is quite complicated. It seems to suggest that base leverage ratio plus various capital conservation and countercyclical add-ons. And when Basel III proposes a base of 3%, also there's no discussion around calibration in this consultation, it does leave you wondering exactly what the leverage ratio's going to look like.

Now sitting on a4.3% leverage ratio under the present PRA definition, I do think we're in reasonably good shape, but the consultation could significantly further complicate that.

So I think, look, from our position, from a capital-generative perspective, we're obviously confident about the ability of the operation to continue to generate capital, to put us in a position to grow the dividend that we distribute to our shareholders, and meet regulatory capital requirements. But I don't think we should conclude for a moment that 10.4% is the endpoint in terms of where our regulators would expect us to be over the course of the next three to four years.

Now when you want to be a little bit more optimistic, I think we'd like to see where we come out on the stress testing, and hopefully at the end of the year, based on what the PRA has learnt from stress testing, the UK banking system will give us at least some clarity on pillar 2, the PRA buffer. And hopefully then it will give us a little bit more insight as to how they may think about sectoral capital requirements, or for that matter, countercyclical.

But what they absolutely haven't done is said, right chaps, you need to be at 12% or 12.5%, and if you get there you can call a halt and take it from there. That sort of clarity has not yet emerged, Alistair, and it would helpful at least if we could get a better insight around the interaction of these buffers as and when they're introduced.

Alastair Ryan

Okay. Thank you.

Stuart Gulliver

Thanks, Alastair. Next, please.

Christopher Wheeler, Mediobanca

Three really quick questions. The first one is on the fixed income level used in global banking and markets which were up 32% quarter -- year on year in terms of the second quarter, which was a very, very strong performance.

I just wondered how much of that was down to June where clearly last year was pretty awful, and how much was down to perhaps strength throughout the quarter, because as I said, it was a very good performance.

The second question related to that really is we've heard the French banks in particular talk a lot in the last set of -- or the last results season on their expansion into Asia, and I just wanted to get a flavor for you as to what you're seeing in global finance and markets in particular, or Global Banking and Markets, in terms of increased competition.

And the final question is, an academic this morning has been quoted as saying HSBC is at the end of the tunnel of litigation, which I thought was quite optimistic. But I wondered if you could perhaps comment on where you think you are in that tunnel.

Thanks very much.

Stuart Gulliver

So doing it in reverse, I also watched on Bloomberg TV the same academic, and I draw your attention to note 25 (laughter).

Christopher Wheeler

I thought you might.

Stuart Gulliver

Then on French banks, look, there's always competition. BNP are a very -- and always have been a very strong competitor in Asia Pacific, and they never really pulled away from the region. SocGen has started to come back into the region. But I wouldn't describe the competition as anything that we haven't always faced.

We've always had strong competition from Deutsche Bank, JPMorgan, Standard Chartered, Citibank, the two French banks, and from time to time, regional players, whether Japanese, Mainland Chinese or the regional Asians. So I don't see this as a landscape change that impacts margins or volumes in any material way for us.

That's not an arrogant comment, that's just a reflection of the fact that this is an extremely competitive geographic area.

Actually, every bank has noticed that the demographics and GDP growth of Asia are much bigger than those of Europe or America and has invested here. So there's nothing new there.

And then June was a good month for Global Banking and Markets, but I don't think it particularly stands out in a way that suggests that April and May were particularly bad. But June was a strong month.

Christopher Wheeler

Thanks very much. Thank you.

Stuart Gulliver

Next, please.

Michael Helsby, BoA ML

I've just got three quick questions, if I can. Firstly, it's actually linked, the first two, but your Banking business does feel like you're reaching a bit of an inflection point in the second quarter. I think q on q, loan growth was 4%. Can you tell us what the loan growth is in constant currency terms, please, just quarter on quarter?

And I note in your Commercial Banking business your trade finance revenue was up 8% q on q, and your cash and payments revenue was up 7% q on q. Can you just comment around what's driving the reversal of those fortunes? Is it volume or is it, I think as you indicated earlier, that we're seeing some movement on margins quarter on quarter?

And then finally, just a bit of a techie point, but the effective tax rate was quite a lot lower in the first half. It was 16.4%. It was 26% in the first quarter. Can you just tell us what's drove the big change q on q? And can you give us an update on what your expected Group tax charge would be if you stopped accruing profits from BoCom?

Thank you.

Stuart Gulliver

Okay. So I'll kick off on CMB trends. So our total loans and advances increased by about $21 billion from the first half of 2013, which is basically term lending mainly in Asia and North America rather than trade related lending, which actually was broadly unchanged.

And we made a big push into North America because we think there will be a renaissance in manufacturing as the US takes advantage of its energy and price.

We've also pushed aggressively into Germany where there's again significant growth in Commercial Banking revenues, and also in China. So this city cluster strategy we're deploying in both the US and in China and in Germany.

So if you then dig into the Asian numbers, Hong Kong loans and advances to customers were up 11% versus the first half of 2013; again, mainly term lending; and spreads in Hong Kong were broadly unchanged; that's about $8 billion extra there. And in the UK, also we've pushed further advances on there, although that actually has resulted in a more or less flat book. That's quite a short book and finances reasonably quickly.

So it's really at the moment, it's volume led, not margin led. We've pushed aggressively. You've often heard us talk about Commercial Banking as being the flywheel in the watch, or the jewel in the crown, or the one that's got the highest entry level barriers to replicate, and we've been investing in this area now for three/four years, and that's starting to bear fruit.

Iain Mackay

On the tax charge, Michael, a couple -- first of all, we'll do the BoCom thing. So the BoCom results are included in pre-tax profit on an after-tax basis. So any impact from non-accrual of BoCom results will have no real impact on the effective tax rate for the Group; and in the round, we would normally expect the effective tax rate to be in the 21%/22% range.

Looking at the effective tax rate, what's driving the effective tax rate, both in the second quarter and for the first half of the year, is really the effect of a number of tax settlements which we've reached in various jurisdictions at levels lower than that for which we were provided, and as a consequence of which we've had write-backs to the tax provision line.

There is also the effect of a non-taxable -- a couple of elements of non-taxable income, part of which, for example, was the disposal of the Bank of Shanghai, which generated $428 million worth of gain, and that's non-taxable income in the jurisdiction.

So it's really those two main factors which are resulting in a lower effective tax rate in the first half of the year, and most of that occurred in the second quarter.

Stuart Gulliver

And again, going back to your question on constant currency, the loans and advances in CMB are up 7% year on year, and 5% year to date.

Michael Helsby

And have you got the quarter on -- sorry, the quarter-on-quarter Group constant currency? We can't really see that in the accounts.

Iain Mackay

No. We've got the year over year. So it's overall for the Group it's 4% constant currency, the puts and takes. And also, there was quite a lot of movement in foreign exchange. Obviously, you saw the movement in sterling against the dollar; you saw the movement in Brazil, Argentina, Mexico. But in the round, the impact of foreign exchange on the results for the Group was actually was very muted, both in terms of the P&L as well as balance sheet and capital. So it's 4% year-over-year loans on a constant currency basis.

Michael Helsby

Okay. Thank you.

Stuart Gulliver

Thanks, Michael. Next, please.

Rohith Chandra-Rajan, Barclays

Just actually following up on the thing you've just been discussing on CMB loan growth. You mentioned 5% year to date. Just wondering to what degree that reflects your already more positive expectations for the outlook. So were you writing business in the first half on the expectation of a more positive outlook in the second half of the year? Or is there any chance you might expect that 5% in the first half to pick up in the second half?

Particularly in Asia, you've talked about the US also, but also curious actually given the UK book was flat whether you're seeing some pickup in demand in the UK.

And then also on CMB, just the 36 basis points impairment charge in the first half, your view on the sustainability of that, at least in the near term.

Stuart Gulliver

Well, actually, we obviously picked up the amount of business we're doing in anticipation of improving economic conditions, yes. So we added to the book in Hong Kong, in US, in Germany, in China, where we saw again revenues growing.

Actually, revenues in the UK actually were up 6% although the book was flat. And, yes, all of this is done in anticipation that certainly GDP is not going to fall backwards from where we've seen it, and as a deliberate push-in to take advantage of the fact that we do think that we have for international clients' opportunities to grow market share.

And you'll see, particularly with the US, Germany and China, some early signs of us executing on this city cluster strategy that you've probably heard us talk about before, which is essentially saying in certain countries, you do not need to have nationwide coverage of all of the country. What you need to do is to identify those city clusters which have very rich veins of revenue that map to your particular strength, which is in our case, export and imports, running across border.

So if you analyze that, you come up with [tens] of clusters in Brazil; a similar sort of number in India, a similar sort of number in Germany which represents 70% or 80% of the addressable GDP wallet. And that's what we've started to do with CMB and it's starting to pay dividends.

Rohith Chandra-Rajan

Okay. Thank you. And just on the sustainability of the credit quality performance?

Stuart Gulliver

Yes. We're not seeing any signs of deterioration. Remember, the LICs are a direct result of a de-risking that we started at the beginning of 2011. So this is not accidental, this is what we did was we --

And part of this is the reason why the revenues have been subdued, is clearly, if you lend to people at narrower spreads you make less revenue, but hopefully, you actually get the better risk-adjusted return because your LICs are lower. And we're pretty vigilant on this, as you would imagine. And at the moment, there are no warning spots around that we can see.

Rohith Chandra-Rajan

Okay. That's great. Thank you very much.

Stuart Gulliver

Thank you very much. Next, please.

Tom Rayner, Exane BNP Paribas

Just going to ask as well on the impairments. I heard what you just said, Stuart, reflecting the de-risking. Can you -- is there any more color? And I'm sure when I've waded through this large document there will be information in here on releases versus gross charge, etc. But I don't know whether Iain can give us any color on how that charge is broken down to get a sense of how big maybe releases have been, where they're coming from, a geographic flavor. Is there anything you can add on the comments about this being a sustainable improvement?

Iain Mackay

Absolutely. If you look at the UK and the Middle East, that's where we've seen the most significant write-backs from a loan provisioning perspective. The Middle East, in reflection to some of the restructuring that was done in 2010 and 2011 to large names in that region, we've seen that come back. So in actual fact, for the region, we've got a net release on the loan impairment charge line, at least in North Africa.

In the UK, on improving economic conditions, particularly within the Commercial Banking book, again, loan impairment charges are down very significantly within that space, with a number of releases coming through restructured positions.

So in the round, where you saw improvements across the business, the UK -- Europe and the UK in particular drove the biggest improvement, followed by Latin America. And that's really a story of lower charges for loan impairment principally through having addressed restructuring requirements in the Brazilian book of business last year, and the fact that, from a house builder's or home builder's perspective, where we took significant provision in Mexico last year, that is very much less a feature in the first half of this year.

And then last but by no means least, again, our US run-off portfolio, the CML portfolio, continues to contribute.

Now if you want to get a blow by blow on the charge versus the write-backs, if you go to page 135 in the interim report, Tom, that will give you all the detail you want by region. Okay?

Tom Rayner

Okay. I'll have a look at that. I don't suppose I could tempt you. Some of your peers give us an estimated range on where they think the impairment charge might be going 12 months out; some even further. Can I tempt you on that at all?

The 36 basis points in the first half clearly does look like a big step-down, and I hear what you guys are saying. Are you comfortable that we might stay within a range around that 36 basis points, or do you think that does feel a little bit low?

Iain Mackay

Well, I got it miserably wrong in the first quarter when I suggested around 40 basis points so I'm disinclined to guess again in that case, Tom.

Tom Rayner

Okay. Fair enough. Thank you.

John-Paul Crutchley, UBS

Two quick questions, if I can, and maybe firstly sticking with that theme of impairment. The thing that actually slightly strikes me with impairment charges is actually the relatively high proportion of a charge which relates to the retail book in LATAM, given the size of that business relative to the rest of the Group. And I just wondered, is that a business that's going through a repositioning? Is it particular cohorts or files of lending that are working their way through the system? Just trying to understand why that charge is somewhat out of kilter with elsewhere and how that should play out over time.

That was the first.

The second question was actually more strategically about the Private Banking business where clearly that business has been impacted by some of the disposals, etc., you've made. But I guess when you look at it in a Group context now, it increasingly almost looks like a rounding in the context of the other global businesses, and not really large enough, I guess, to either change people's perceptions of either your growth rate or the rating that should be applied to your earnings.

And I just wonder, in terms of obviously still breaking it out how you perceive that business over the longer term. Do you think it could be a more reasonable contributor in time, or might it be time to actually fold it back in with actually what are three very substantial global divisions?

Thank you.

Stuart Gulliver

Sure. That's a good question on the Private Bank. I'll take that one and Iain can talk about the changes in Latin America that have resulted in the slightly higher LICs at this point in time.

So you're right that the stage of development that we've got to at the moment leaves us with four global businesses, one of which is 2% or 3% of the global PBT of the Group. But actually, I see the Private Bank as being a core part of frankly the value proposition of HSBC. But the fact of the matter is we bought this private bank, Republic National Bank in New York, back in 2002, whenever we bought it, which ended up with a client base that didn't foot to the natural geographic footprint of HSBC.

And actually, in many, many ways -- actually we bought it apparently in 1999 so I'm being told -- and it actually had a client base that had no relevance to a large part of HSBC, whereas I think that private banks should consist mainly of the self-employed business owners that we bank in commercial banking and the [C-suite] of the Global Banking and Markets' clients.

So it should be the guy who -- or lady who builds up their own business, either does a trade sale or an IPO. That creates the wealth event. Then you've got your [AML] and KYC done because you've banked them for years, or it should be the chairman, chief executive, the C-suite of Global Banking Markets' clients.

And to be honest, that was the private banking business of HSBC in Asia. That's exactly what the Private Bank in Singapore and Hong Kong has done throughout its history. So its clients are the tycoons of Hong Kong, right back to the days when they were actually, frankly, small SMEs.

So what we're doing is repositioning that private bank, and the sale of the portfolio to LGT $12 billion AUM, it's $12 billion AUM of clients from countries in which we don't have operations, or represents therefore clients that we can't get comfortable from a global standards point of view, simply because we're not able to do the due diligence.

So as that passes through, I'm confident that we can rebuild the private banking business back to one that makes $1 billion to $1.5 billion PBT per annum. And I think that we would for the time being want to keep it as a separate group because I think it's important to the retention of top quality private bankers that we don't subsume it within a retail banking business, because clearly, the nature of the client base, and therefore by definition the nature of the staff, is quite different.

So I still think we can get this back, and in fact I don't think we can get it back, we will get it back to a $1 billion to $1.5 billion type of annual PBT. And I do think that there is a logic in having it managed as a discrete business, because I think the nature of the business requires that separate oxygen, that separate culture.

So what you're really looking at is a point of restructuring of a business that frankly became unrelated to the HSBC Group. And the great thing in the first half is that we got $5 billion of AUM into the Private Bank, most of which came from referrals from Commercial Banking and Global Banking and Markets. So the referrals from Commercial Banking were about 3 times what they were at any other previous point in history; and the referrals from Global Banking Markets, I think, beat history by a significant amount because there simply hadn't been any.

So we're starting basically to try and play an integration of it within the Group without having it folded into Retail Bank and Wealth Management. In other words, it's got to be part of HSBC but have a distinct life as a global business. And I do think it will get back to being $1.5 billion type of profit contributor.

John-Paul Crutchley

Okay. That's helpful; very much. Thanks a lot. And on impairment in LATAM?

Iain Mackay

Now you see, I thought that was such a good long answer that you'd completely forget about loan impairment charges and not have another to follow.

Stuart Gulliver

Yes, we we're playing for time.

Iain Mackay

So, look, JP, when you look at Latin America, a couple of factors, and you saw most of this come through last year, and this really goes right back to origins in 2012 when we saw a bit of the stress coming through, particularly the Retail Bank Wealth Management; and then within Commercial Banking, principally within business banking, which is at the lower end of the SME sector within Brazil, and largely before some of the repositioning had taken place in some of these businesses.

So you'll recall that we saw a need to restructure some accounts, and as we did that, when we looked at the restructuring, the methodology for loan impairment charges against that restructuring in early 2013, it was clear that we didn't have a consistent application of Group policy with respect to that.

So in 2013, both the first and second half of last year, we adjusted the methodology for the restructured accounts within the Brazilian business, and that was certainly what drove a very significant part of the step-up in loan impairment charges within Brazil last year. And then this year, as we completed the review of our models around the loan impairment charging in Latin America, we've addressed the requirements for the non-restructured book of business, and that's added about $70 million to the charge in the first half of the year.

Within Mexico, last year again was largely featured -- was a feature of the Commercial Banking business with higher loan impairment charges to three home builders to which we we're exposed on the change of housing policy in that marketplace. And in the round, what we do tend to experience, and you can track this back many, many quarters, is just a higher incidence of loan impairment charges within the Latin American business, where interest rates do tend to run at a much higher rate, and the delinquencies that come through Retail Bank Wealth Management as a consequence is higher.

But I think in the round, if you look at the loan impairment charge makeup for the Group, we've got 10 countries which represent about $119 billion, so $11 billion of our gross loans and advances to customers outstanding. But those 10 countries represent about 62% of the overall loan impairment charge for the Group. And Brazil and Mexico feature number 1 and number 2 in that league table.

John-Paul Crutchley

Okay. That's very helpful, thanks - on both answers. Thank you.

Mike Trippitt, Numis Securities

Just a couple of questions around the UK business. Stuart, you've talked about in your outlook the potential for a Q4 rate rise. I just wonder if you could give a view as to how that plays out in terms of margin benefit versus credit risk. That's one area.

The second is just related to that is another PPI charge coming through, but a much bigger Consumer Credit Act charge or provision being made. If you could just talk around still continued conduct litigation risk. And maybe if I could invite Douglas, who gave some pretty robust comments in his Chairman's comments on regulation as to how you think ring-fencing will play out in the UK.

Douglas Flint

Clearly, there's still a lot of definition being done with the PRA in terms of the shape of the ring-fencing, but I think one of the comments that we've been making to public policymakers is that it's a huge commitment of resource, technology, operations and people over the next couple of years if we're going to be fully prepared and tested before the deadlines in 2019.

And to try and do that in the context of an ongoing competition review, which will take the same people in terms of inputting data to that review, which could come up with further structural changes, is actually very challenging. You wouldn't try and do a reorganization when the thing was under review at the same time. So that's one of the points.

I think you'd throw into that too the uncertainties that continue to exist in Europe in terms of structural reform which might come out of the follow-up to Liikanen’s proposal.

So there's quite a lot of uncertainty, and that's one of the comments that we're making.

The broader comment was that simply when you add up the competition, review, the wholesale market review, having to do as Iain has said in an earlier question, four or five different versions of stress tests on top of resolution planning and just the business as usual regulatory reform, the aggregate strain is really getting quite marked. And we were trying to make that point in a coherent way, and I hope it's received not as a complaint, but just as a statement of fact and how we're having to deal with it.

Stuart Gulliver

So if we look at the various top-ups, we topped up GBP66 million to the PPI provision, and that still gives us [13 months' cover]. There is nothing I can really say about a forward outlook on this. We'll top it up every quarter as we see what the predicted behavior is.

Iain Mackay

It's certainly -- when you compare what we've taken over the first two quarters of this year and compared to the same two quarters last year, the charge is down significantly. Incoming claims have been generally in a downward trend. It would be good if they were in a much faster downward trend, but they generally have been in a downward trend.

And we adjust the reserve on a quarterly basis really informed by the number of claims we see coming through the door. Uphold rates are reasonably consistent, but certainly, the claims coming through the door, it's beginning to drop off, and has been now for a couple of quarters.

So hopefully, we're getting the worst of this behind us, but we do -- I think it's mission impossible to take one view of this and say we've absolutely got it covered, but as to Stuart's point, we've got about 13 months of coverage on the PPI.

Stuart Gulliver

So on the Consumer Credit Act, the Consumer Credit Act, as you're aware, Mike, is a very complex piece of legislation, and it would appear that we should have reminded our customers on their annual statements that they had a right to partially repay their loans. Now their loan documentation when they drew down the loan -- so the contract that evidences the debt, specifically says that they can repay their loans in part, but we are required by the Act to remind them in the statement.

We did not remind them in the statement, and therefore we -- and although we do not believe any customer suffered a detriment as a result, indeed actually quite a large of the book was partially repaying, we nevertheless as a result of that statute now have a requirement to put aside certain of that interest. So that's a direct result of the Credit Consumer Act in the UK.

And then on your question on margin versus bad debt or what happens when interest rates go up, so the logic is the way it plays through should be we will make slightly less money in Global Banking and Markets because balance sheet management will be impacted negatively by rising rates.

There will be a small negative in terms of the funding of trading positions which should be offset by a mark-to-market gain in the markets' P&L in rates and credit. And then the big benefits will be in Commercial Banking, Retail Banking Wealth Management, which have the big deposit bases.

So on the other side, what we see in larger bad debts, clearly, we are lending on the basis that rates will go higher. You may remember that we started stressing new mortgages at 7% way before the Bank of England required that to be done. In fact, from the very point where there was a big push to rebuild the mortgage book, we were only lending to people on the basis that the loan was still affordable for them at an interest rate of 7%, not where they were currently lending. So I think on balance that higher interest rates will benefit HSBC.

Mike Trippitt

Sure. And just to come back on the Consumer Credit Act in as far as you can say. This is a -- that provision seals it, does it? This is not a now a creeping situation where there could be a creeping charge? You've dealt with the issue?

Iain Mackay

That provision covers the portfolio of loans which is subject to that particular piece of legislation.

Stuart Gulliver

That's the entirety of that particular part of the Consumer Credit Act.

Mike Trippitt

Okay, great. Thanks.

Stuart Gulliver

So we have time for two more.

Ronit Ghose, Citigroup

Just quickly on BoCom to follow up. I'm looking at the note. It looks like at the end of the first half, the value in use is about $5 billion more than the market value. And if I look at it today, it's more like $4 billion. Is there -- I'm just wondering, is there any kind of feedback loop from the market price when you think about how you do the value in use at least in terms of the assumptions? Obviously because you're still valuing it at quite a long way above the market value.

My second question is just a follow-up on Douglas' comments about obviously the pressure from regulation. On slide 15 of your deck, you give us a very helpful number on the number of staff you have in risk and compliance. How many of that risk and compliance staff, the 24,000, would be which I'd consider business-as-usual risk, as in credit risk, market risk? Or how much of this is really linked to compliance, financial crime, etc.; really stuff that's been imposed on you since the global financial crisis?

And my final question is I'm just looking at LATAM, and just feeding back to your earlier comments, Iain, about loan losses, and I'm just trying to work out some of the deltas from here. Because Q2, obviously, the result if very depressed vis-a-vis I guess your expectation, at least market expectations. So we're looking at what is a double-digit number in profit terms in Q2. So to get it back to something more respectable, I'm wondering what levers you expect to pull, or expect to see happen externally or internally.

Iain Mackay

You want me to take BoCom first?

Stuart Gulliver

Yes.

Iain Mackay

So the starting reference point for the valuation tests around BoCom is by reference to the market value compared to the carrying value. And when you then go into the next phase of evaluating it from a value in use perspective is when there has been a prolonged period of the market value being considered -- it being below carrying value.

So that's really what takes you through the valuation, the accounting evaluation process of, right, there is a possibility of impairment here because market value is below carrying value, and has been for a sustainable period of time, which in the case of BoCom, it has been now about 24 months or so with, I think, the exception of one short period in 2013 when the market value has been below carrying value.

But there isn't -- apart from that, there isn't a direct feedback loop from the market value into value in use. Value in use is informed by the profitability of BoCom, our prospects for growth of that business. It's basically a long-term discounted cash flow model. And really then all the assumptions that you would expect to build into that discounted cash flow model, informed by the profitability and the performance and the growth prospects for BoCom. That's what informs value in use.

Stuart Gulliver

On Latin America, as you can imagine, there is a lot of work going on to restructure both the Brazilian and Mexican operations. First of all, we needed to restructure, actually get them to Group standards in terms of their impairments, the way they've dealt with models in respect of impairments and accounting treatment.

Secondly, to de-risk the business in line with the global standards.

And then the third stage will be to rebuild that business, addressing an addressable client base that we're comfortable with in Global Banking Markets in CMB and in RBWM. And that will take some time to do, but we're tracking towards that.

So there aren't -- there's not a cookie-cutter couple of levers that I can honestly point to, but they are in the process of a significant restructuring.

Iain Mackay

And your last point, which was around headcount focused on compliance, of the overall risk and compliance headcount of about 24,000, we have more than 6,000 which is dedicated to compliance. And comparing that number to the first quarter of 2013, we've added more than 2,000 people, again focused in the areas of regulatory and financial crime compliance over that period of time.

So there has been a very significant step-up, both in terms of investment in ongoing spend with respect to compliance over the course of the last couple of years.

Stuart Gulliver

We've got now about 6,300 people in compliance compared to 4,164 at the end of the first quarter of 2013.

Ronit Ghose

Great. Thank you for that. It's really useful. It's a growth business, compliance.

Stuart Gulliver

It's a very big area, yes.

Iain Mackay

Makes much more money than in equities, I would imagine.

Ronit Ghose

Oh, absolutely. I made a wrong career decision 10 years ago (laughter).

Stuart Gulliver

Thanks very much. Next one and last one, please.

Sandy Chen, Cenkos

I'll keep it brief as well and not be a glutton for punishment, but thanks for the additional disclosure on repos on page 154.

And I just wanted to ask if you could talk a bit more about the growth in non-trading reverse repos, and does that represent a change in customer strategy? Who are these sold to? Is it in -- are they still booked with GBM? And also, just the dynamics of that; the effect on net interest income, trading income, maybe the RWAs and capital calculations, and how that business compares with others.

I would have thought that many of the more IB-weighted banks that don't have as strong an A/D ratio as yours would be cutting back on this kind of business, and that might be a good competitive advantage for you.

Iain Mackay

If you go back and look at the change in methodology that Samir and the team took to repo, reverse repo book, one of the reasons that we provided a great deal more disclosure is that the -- we have different accounting treatments based on the purpose for which those repos are used.

So we've got a proportion that sits within the trading portfolio of Global Banking and Markets, and part of repo, reverse repo, which is non-trading and it sits under loans and advances and customer deposits.

There is obviously an adverse effect overall in net interest margin because, obviously, repo reverse repo activity is at much, much narrower margins, and that has an adverse effect overall on Group NIM.

But I think in terms of strategically the approach to running -- the purpose for which we do repo, reverse repo action has not changed.

Sandy Chen

Okay. And in terms of any -- is it a potentially decent opportunity to grow --? The NIM might come under a bit of pressure, but actually, it's a decent source of interest-earning asset growth, relatively low risk.

Stuart Gulliver

It's a reasonable source, Sandy, but it's going to be constrained by the leverage ratio. So the ultimate constraint on it will be the leverage ratio. And, clearly, we will always want to run with a conservative leverage ratio because it's kind of part and parcel of the whole mindset here.

But you're right. Up until the constraint of a leverage ratio, we have greater capacity than others do.

Sandy Chen

Okay. Thanks very much.

Stuart Gulliver

Thank you. Thanks very much. Thank you, operator. That brings the session to an end.