

Nomura Financial Services Conference Transcript of presentation held by Stuart Gulliver, Chief Executive Global Banking and Markets, HSBC Holdings plc, on 03 September 2009

Speaker key

CH Chairman

SG Stuart Gulliver, Chief Executive Global Banking and Markets, HSBC Holdings plc

CH Good morning everybody, it's my pleasure to introduce today's conference, the Nomura Financial Services Conference, and we're delighted to welcome Stuart Gulliver from HSBC as our first speaker today. Stewart is the chief executive of GBM and HSBC global asset management. Stuart is also joined on the podium by Nick Collier; head of strategic finance, and by Alastair Brown, manager investor relations. Stuart.

SG Thank you. Good morning. First of all I'd just like to thank Robert and Nomura for inviting us to present here this morning to you all. The presentation obviously contains the normal boilerplate forward looking statement. Then I want to basically run through two sections in this presentation; the first will be just to put some context of the group's results, HSBC's group results for the first half, and then dive into global banking markets, which obviously is the business which I run within HSBC.

So if you look, first of all, at the group results, and I suggest we focus on the bottom section of this chart, the profit before tax; and this fits us down into the various customer groups that HSBC has. The key point; and you will have gone through the half year results, I won't labour this in tremendous time usage, but HSBC has built up a business that is very diversified. We were hugely criticised, actually, by Knight Vinke for our diversification, but actually our diversification is one of the reasons we've had a better credit crises than some other institutions. We have deliberately built a universal banking model that's diversified by customer group and by geography. So if you look at the first half of '08, the second half of '08 and the first half of '09, you'll see in essence that different parts, different customer groups of HSBC performed at different points of the economic cycle during this financial crisis.

So the second half of last year global banking and markets did very badly. We, obviously in line with most other wholesale banking businesses within the industry, did not have a strong 2008. Although it would be fair to say we did make \$ 3.5 billion profit, which is a great deal more than some others did. Having said that, as you can see in the second column across, global banking markets made only \$793 million in the second half of last year and a great deal of the profit was made in CMB, and in PFS outside of North America. In the first half of this year global banking and markets made 125% of the group's profit. The point I'm really trying to illustrate is we have set up a universal banking model, and we'll talk a little bit later about whether universal banking models will be challenged by regulators, ie running wholesale banking along with deposit taking,

but one which actually delivers a robust financial performance at most points of the economic cycle.

And, again, at this point in the economic cycle the PFS business, apart from Household in the United States, will struggle because interest rates have been taken, by central banks, near zero. And therefore the benefit of having an enormous deposit base actually becomes somewhat of a burden because you cannot make so much money on your deposit base. The very simple math being if interest rates are 5%, you put a deposit with me, I give you 2% and my margin's 3%, if interest rates are 50 basis points I give you 25, my margin is now 25 basis points. My branch network costs the same. So that's why, in a very low interest rate environment, PFS and CMB will struggle with the liability side of their book, but on the other hand, in global banking markets we can take advantage of very low interest rates because they create benign capital markets conditions for trading and sales. But also we're able to produce an offsetting P&L in our balance sheet management number. So we have deliberately created a business that is diversified by customer group and by geography. This company is not eventually reliant on any one particular geography.

You can see, again, the changing contribution of various parts of the world, to HSBCs, bottom line. But again the main thematic that essentially comes through is that we are very geographically diversified. We actually have a very strong European business. European business falls, by the way, in the second half of '08 to the first half of '09, because you've got the sale of the French Regional Banks in the second half of '08, and you've also got the fair value gain on our own debt, from holdings that are in the European piece. But, again, you can see quite strong geographic diversification; there is a very big emerging market footprint here. But there's not just an emerging market footprint, again, some of the thinking that begins to emerge is, oh well, this is an emerging market bank, what happens if China has a problem? Well, actually, if you look across the geographic bars there's a very substantial business in Europe, and a very substantial business in Latin America and in the Middle East as well.

We have deliberately tried to create a business that doesn't have a single point failure. Actually the origin of this comes back to pre 1997. I've been in the group actually for 29 years, as of actually two weeks time, and the thinking in HSBC as we ran through the eighties and nineties, and we came up to 1997 in a hand over, was to avoid being a victim of what may have taken place post 1997. So we deliberately set out to diversify away from Hong Kong. That thinking about not being reliant on any one country or any one business is very deep in the DNA of the firm. So, therefore, this diversification you will see repeating time and time again in the way we conduct our business.

We also have always put a store on capital strength. Again, for a period we were very heavily criticised by a number of analysts, not Robert but a number of analysts, for having too much capital, for having a lazy balance sheet, and were encouraged to pay extremely large dividends in order to leverage up. We resisted this because, again, within the DNA of the firm is this thinking, if you start as a bank in Hong Kong, which is actually rather a small place, and you start before even central banks existed in many Asian countries - I mean Hong Kong monetary authority only came into existence in 1991 - if you pre date central banks and you pre date the existence, often,

of ministries of finance, and you're a guest in everybody's country, you cannot assume you have lender of last resort access. You have to assume you're going to have to look after yourself. You have to assume that there isn't a Fed window or a bank of England discount facility you can turn to, because actually you're a foreign bank in Malaysia and you're a foreign bank in Singapore. And you're probably bigger than most of the central banks, until very recent parts of history, in all of those countries. So you've got to jolly well make sure you can look after yourself, which is why we have this obsession with both capital and liquidity.

It is because we operate in parts of the world in which banks runs are pretty irregular, and actually where there are not central banks sitting behind you, and where you're not the national champion who can necessarily rely on a government coming in to help you. So, therefore, we have always run with a conservative capital ratio and obviously we conducted a significant rights issue earlier this year, and for all those of you who participated in that we are genuinely thankful and extremely grateful for your support for the deal. The support was very high, it was a 98% takeover of the rights issue, and it was record rights issue. But I think the more important point in the top left hand box is that actually we continue to make a profit of 4.7 billion, and even after paying dividends net of the script that came back, actually we increased our capital ratio. So we are one of the few banks that actually are growing its capital ratio from retained earnings after paying a covered dividend in cash. Which if you think back is rather a statement of the rather ordinary, except in the last two and a half years that has become rather an extraordinary thing to say.

So our capital ratio was 10.1% at the 30th June, and again the important thing, as well, to point to is the core equity is 8.8. We, again, have never been an institution that focused heavily on complex or hybrid capital instruments. We have tended, again, to focus on equity. And that partly also reflects an Asian investor base where about 30% of the register is Asian, that actually, to be honest, does not understand complex hybrid instruments and thinks equity is equity because that's the loss absorbing piece. So that, again, for a while looked terribly old fashioned, looked terribly out of date, but actually is really where we think the industry and the regulators are going to take bank capital over four or five years is actually to equity. And the second strand or pillar to the sort of financial strength is obviously funding and liquidity, Again, if you don't have access to central bank windows you've got to make damned sure that you're actually funded from stable sources.

So one of the mantras we have has is that you raise deposits before you lend. We therefore have set out to not be reliant on wholesale funding, and of course the only place in the world where we are reliant on wholesale funding is household, which because it's not an FDIC insured bank can't take deposits. And in a way that kind of proves the point. So we have always had an AD ratio set by country, and I think this is important for me to explain, our vast deposit ratios are set by country and by currency, we do not assume that deposits are fungible, either between the legal entities or across currencies. So we don't take our AD ratio in Malaysia and assume that we can get those Ringgit swapped into Sterling to us in the UK. Every country has an AD ratio, it's distinct. What you see, of course, is the aggregate at 79.5, but that aggregate does not assume that there's fungibility between deposits. So AD ratios are set at legal entity and at currency level, okay. So therefore it's even more conservative than it appears to be on the surface, at 79.5.

We are probably going to reach a stage where we will need to set a floor on our AD ratio. We're not convinced that having an AD ratio of 60 or something similar actually make a lot of sense from a financial point of view. There is a point at which keeping on getting deposits; particularly in a very low interest rate environment where you can make no money on those deposits may not be a sensible business proposition. But if we set a floor on it the floor is going to be around the 79 type of level or lower, it's not ever going to be that we take this AD ratio back above 100. We have always operated with AD ratios under 100, and that's always been the guideline and it will remain the guideline. But, as I say, we have actually been the beneficiary of a significant inflow of funds. Interestingly actually the funds haven't flowed out again. So although there was a massive inflow in the fourth quarter last year, as various financial institutions got into difficulty, we haven't had an outflow since we have been nationalised. We equally haven't had a further inflow. So it's almost been slack water since then, except in Hong Kong where we've continued to have an inflow, and in Asia Pacific, which is why the AD ration has now improved, as it were, from 83.8 down to 79.5. That is happening in Asia. Here in the UK it's slack water. We've picked up a huge amount of deposits in the fourth quarter of last year, as you might imagine, but they have stayed. We haven't continued to see deposits come in.

Another thing that a number of other institutions may suffer from here in the UK is the price competition from the government owned banks competing for deposits and what that does for interest margins. Obviously Lloyds and RBS have AD ratios near 150, so if they're ever going to get weaned off government ownership they need to get their AD ratios down towards 100. That means they are going to compete for deposits. Clearly if an AD ratio of ours is at a lower level we have less pressure to compete to retain those deposits. So it won't result in a net interest margin compression if RBS and Lloyds aggressively bid for deposit, because we're not in a position where we need to fight to keep those deposits, we've got a very low AD ratio as it stands. That may impact other UK or foreign financial institutions based in the UK far more than it impacts HSBC, but we will still continue to run with a very conservative AD ratio. And, as I say, we may well set a floor as well as having caps, caps set by country and by currency.

Now just switching into the business that I run. We had a very strong first half of 2009, in keeping with the industry. So the industry where those banks decided to remain in wholesale banking benefitted from very benign conditions. It's absolutely the case that where governments injected significant amount of fiscal and monetary policy stimulus, taking interest rates near zero, and with a number of financial institutions having fallen out of wholesale banking there were very benign conditions for everybody's wholesale banking business. So therefore the numbers that we have are equally reflected by those that Barclays, JP Morgan, and other institutions have.

So the issue then becomes how sustainable is this. And I'll go through the rest of these slides to try and build a picture for you as to why we think our own business has certain differences from others, which will add to the sustainability of these revenues. One of the obvious ones is that we're actually in emerging market geographies and a lot of state owned banks can't really compete now in countries other than their own. And the reason that they can't compete in countries other than their own is really two fold. One is the governments that have actually recapitalised them have elected to have to see their money being put to use in their own country.

So let's take a non UK example. Let's look at Commerce Bank, and it's very difficult for the German government to allow Commerce Bank to use the money it's put into it, for example to do a desalination plant in Qatar. It's going to have to use that money to do mortgages in Munich or to support the [unclear].

So therefore there is a once in a long period of time reshuffling of market share taking place in emerging markets and the beneficiaries of that are the local banks, the regional banks, and we think four international banks in particular. HSBC, Standard Chartered, BNP and JP Morgan. There are therefore significant market changes taking place and it's driven at two levels, it's driven both by the international companies that do business and trade with the emerging markets, who are thinking to themselves, you know what, Citi Bank was my house bank, it was in 96 countries around the world, where does Citi Bank's international network end up? I used to bank with RBS and I used to bank with RBS in Asia Pacific, but that was an ABN network and that's now going to be shared between ANZ and Standard Chartered etc, you know what, I better shift my banking business to a bank that I know will be in Malaysia in ten years or in Saudi in ten years, and in wholesale banking in ten years. So there is a big push by CFOs to switch to institutions that they are convinced have the financial strength and commitment to those countries to be there. Because if you're going to issue a bond it would be quite useful to have someone make markets in it for the full ten years of its existence. It would be quite useful if you've done a swap not to have to notate it after four years.

So there's a significant change by multinationals to push their business to the banks that they believe will remain international and the banks that they believe will remain in wholesale banking. Within those individual countries, at local level, the same phenomenon takes place. So if you are sitting specifically in Hong Kong and you historically had quite a bit of lending from some German Banks, German lenders banks, you've received a lot of letters in the last year saying actually we're closing and in the next six or seven months can you repay us? So again, what people are doing, once the CFOs all meet and talk is saying well I need to switch my business to those institutions I'm pretty sure in Hong Kong and I'm pretty sure in wholesale banking. So there is that change that is significant and not about the general phenomenon and very low interest rates, survivorship buyers, and the fact that the capital markets in debt in the first half had a huge amount of funding brought forward. Which, of course, is a phenomenon that doesn't repeat over time. The strand I've just described, emerging market piece, or the international connectivity of European and US companies doing business in emerging markets is actually sustainable change in market share and who does business with whom.

Now, within our own global markets business we again have this diversification obsession. What you'll see within global banking and markets, and I think we give actually far more disclosure having looked at some of our peer group in Europe in particular, than others do, as to where we make our money. But in essence there are five businesses here that have revenues over \$ 1 billion, which is actually six, credit rates, foreign exchange, security services, financing and capital markets and balance sheet management. And the biggest – if you park balance sheet management aside, and I'll come back and talk in detail about that and look at the five that are effectively customer facing, which is credit rates, foreign exchange, security services and financing, the largest one is 22% of the total which is the rates business. So, again, this is very

diversified. The other thing to think about, and there's an obsession with the BSM number and dismissing the rest of it, even though BSM is a quarter of the 12.2 billion at 3.3, is of course there are actually some businesses in here, four of which actually will benefit as rates go back up. So when rates go back up BSM will not make as much money, but actually as rates go back up security services will make a lot more. Because obviously you make money from the balances and the balances have to have interest rate for you to earn anything on those balances. And actually if the economy improves, which is when it seems like rates are going back up, equity markets will be more active and again your security services business will make more money. Payments to cash management will make more money because there is a value of funds attached once rates are higher than the zero band. Asset management will make more money because, as I say, if interest rates have gone back up well it seems as if there's some form of inflation and some have fallen back in recovery and so on with the Principal Investments business.

So there are four businesses that actually collectively between them, to put this another way, were actually \$1.2 billion down first half of '09 versus first half of '08. So there's a \$1.2 billion negative head wind sitting in within this significant increase in P&L from security services, payments cash management, global asset management, principle investments. So a \$1.2 negative number run through this already. And, as I say, that will be the bit that will crack in, we believe, a substantial revenue stream which will partially offset any decline in the BSM number that comes from rising rates. This is obviously important and this is taken straight out of the half year results but our write-downs have slowed and certainly so far in the third quarter there is no change in this trend of slowing. Our loan impairment charges are high in the first half of 2009, and again I think that's probably cyclical in the sense that bad debts, rather like unemployment, are lagging indicators, they're not leading indicators. So as the crisis moves from being complex traded assets in the dealing rooms it kind of moves into the banking arena out of markets into banking, as corporates find that their earnings are falling dramatically. So far in the third quarter there has been no further impairment but obviously we look at this on a daily basis. And the AFS reserves have continued to actually decline somewhat during the third quarter. So the \$17.5 billion number is somewhat better as at the end of August.

We continue to stick to the stress test that we put out, both in the full year results for 2008 in our annual report and account, and also we put out, when we did the rights issue, we think that on the AFS reserve our impairments will be \$2 to \$2.5 billion and our actual losses will be in the region of \$600 to \$800 million. And there is nothing that's happened post the half year to suggest that that has changed in any way, shape, or form. This will take, though, a long time to run off. The reason it will take a long time to run off is that these assets are all risk weighted at 1,250% under the Basel calculations. And therefore there is no bank that is going to buy these. So therefore it's only the hedge funds that are going to buy the type of ABS that sit within our AFS reserve. Actually what happened in the first half is that the hedge fund community bought the mezzanine piece so we actually have a lot of these assets- as we argued the whole way along and which explains why the stress test is considerably lower than the AFS reserve- they're actually pretty high quality and they tend to be marked at 60 to 70 cents. If you're a hedge fund and coming in you buy the stuff that's actually marked at ten, because you're just looking to trade it from 10 to 20, so you're actually buying the kind of mezzanine in the worst tranches, you're not actually buying the pieces that we own. So the issue for this is do we have the funding to sit with this?

We just talked about an AD ratio of 79 so we have the funding to sit with this. Do we have the capital to sit with this? Yes, we do. And actually why do we have the capital to sit with this? Because we believe the stress test is correct, that we won't lose more than \$600 to \$800 million on this thing over the next couple of years. And actually if we didn't sell any, this would take about five to six years to amortise down. And if we're right on the loss expectation, which is comfortably inside the capital we are creating (actually global banking and markets made \$6.3 billion in the first half, let alone as a group). And we have the funding, which we do because our deposits obviously exceed our loans. For every 79 loans we've got 100 deposits we can sit comfortably funding this, we have no funding pressure, we have no capital pressure on it. So we're not going to be forced to sell it.

Obviously with the changes in accounting treatment and the move from AFS and replacing it with essentially either amortised cost or trading we are unlikely to be an early adopter of these IASB rules unless we were certain that the AFS reserve was not going to be taken as a deduction from capital. So, in other words, if the AFS reserve went through retained earnings and came off capital then we are simply going to wait until 2012 when we would have to adopt anyway and by that time the amortisation of this will have taken the number down to an immaterial number in terms of what would actually happen if it was a deduction from capital. So we've done that analysis of what does it look like by 2012, and it really isn't a significant issue by 2012 even if the full AFS reserve had to be taken against retained earnings. It's partly because a large chunk of this would actually be able to be reclassified and held on an amortised cost basis because they are loan lookalikes and loan equivalent and would get that treatment. And the bit that isn't amortises down between now and 2012 to a number that really is quite manageable and is not a significant impact on our capital ratios.

So those are the financial numbers for the first half. I mean, this was a record first half, we made more in the first half of 2009 than we made in our record year, which was 2007. So it's a very significant number and it proves our diversification as a group. Global banking and markets made 125% of the group's P&L. That's a good thing in the sense of it proves that we have a diversified business model. We have no intention, though, of moving global and markets the way, for example, Barclays have obviously moved with BarCap, to make this the dominant revenue stream of HSBC. It just so happens that we have a business that has enabled the group to have a good first half. We would hope that global banking and markets is roughly a third of the group's P&L in a normalised environment, and PFS and CMB being roughly a third each, and private banking kind of having the balancing number. We don't intend to build a business where global banking markets becomes the P&L of the HSBC group. So the point is not that this is a line of travel that changes the group's risk profile, simply that we have a diversified business and this first half was the first half in which global banking and markets could excel. Last year, actually, the CMB business did phenomenally well. So it proves that diversification point not any changes in strategy.

So for global banking and markets itself, I'm going to run through four key blocks on this. You may recall that the period 2003 to 2006, those of you who have owned HSBC for a long time, I co-headed global banking markets with a guy called John Studzinski from Morgan Stanley, and

we had a period from '03 to '06 where there was an attempt to replicate a bulge bracket strategy that didn't work. In September 2006 I repositioned the global banking and markets business, the banking piece came under my responsibility as well as markets, and I repositioned it with a strap line or a mission statement of being emerging markets led and finance focused. The problem with this strategy for analysts and investors is it doesn't look like anyone else's, and this is also a problem for journalists because people like to have little kind of strap lines and bullet points that say just like Deutsche Bank or just like Standard Chartered. And it's actually not just like anyone's. We have a huge European business, Standard Chartered doesn't, and we're not into complex derivatives the way that Barclays and Deutsche Bank are. But the reason we've picked upon this, it's a statement of the rather obvious strength that HSBC has, we are in 83 countries, I have dealing rooms in 67 countries, we are in the emerging markets and very significant.

We also are a bank with a huge balance sheet and as we talked about earlier, tremendous funding and a tremendous capital base. So therefore our ability to finance large transactions and our ability to focus on the emerging markets is obviously self evidently an existing precondition for HSBC as opposed to some aspiration like, one day we'll be like Goldman Sacks. It's much easier to say, well actually we already are massive in the emerging markets, it's a huge bank, and we can finance very large deals. What we've done also is change the whole coverage model, bring together the MN&A bankers with the corporate banking guys and, effectively, there is now an integrated banking platform. We have increased our market share in a number of areas, and I'll come back to this, but we're also now, I think, very well positioned across some of the very significant trends that will now unfold in the world.

We believe that this financial crisis will probably have marked the high point of the US economy and therefore that the marginal GDP growth and I stress the marginal GDP growth of the US economy will still be incredibly important and a huge source of investable funds will come basically from East and South of where we're sitting today. We believe that we're actually positioned, therefore, in the geography for the next 25 years. We also believe that actually we have three significant trends in addition to that marginal GDP growth that will benefit us. Our European business, which is large and strong will benefit, also, from the huge demographic trends that run through Europe. Massive unfunded government pensions, therefore huge push into bond markets and into contractual savings products. Meanwhile, in emerging markets you have a transition from either no provision of pensions, health care or schooling, to again people saving for their own provision of those, or in the case of China a movement from where the party provided all of those things to in future people having to save for themselves to provide those things. All of which also clearly created an enormous demand for banking services and an enormous demand for fixed income and financing products.

We also believe there will be an increase in the trend to South to South business, and I'll talk a little bit more about this in a moment. But emerging markets to emerging markets will emerge as a significant business opportunity for ourselves and a number of other institutions. We have actually got recognition now that this emerging market led finance focused strategy is working. One can always pour scorn on magazine awards but the fact that these correlate with the fact that we said we would be emerging market led, so we're debt house in Asia, Latin America and the Middle East, and financing focused global bond house, debt house cash management, kind of

proves, loan house etc, kind of proves that we are doing what we said we would do and we're getting recognition for it. So, as I say, although one can always be cynical about these the point of this is not to say, look how clever we are, but to point out that we are getting recognition in those areas that we have focused our business: financing and emerging markets. So what we don't have here is a M&A award, because this is a financing house. Yes, we may do M&A but we'll do it off the back of financing. And we're not expecting to win an US award anywhere. So the fact that we're getting Mexico is great, we're getting Turkey is great, we're getting debt house in Turkey and Mexico, proves that we've executed what we said we would execute.

Our regional positioning is, we think, actually quite unique and I think an important point to look at on this is if you look at the first half of '07 versus the first half of '09, is just to look at what the changes are. If you see the first half of '07 was a normalised half and the first half of '09 is the first time since the financial crisis things have actually been moving through. What we actually see if we've grown our P&L in Hong Kong, Asia Pacific, the Middle East, Latin America. North America has remained actually stable and Europe has grown enormously. And Europe has grown enormously for two reasons, one is it's where pure global dealing rooms are and where our global business is run from, so it partly reflects emerging market revenues actually, that are booked here. We have centralised risk management, actually, in London and Paris, but it also reflects the fact that we have a substantial corporate banking presence in both France and in the UK. But I think it's interesting to see that there's growth in all of them – North America is flat, North America is not an important market for HSBC's global banking and markets business, it's important for its international connectivity, it's important to bring Asian issuers to US investors, Middle East issuers to US investors, US issuers to Asia investors, or US corporates, and do their payments for cash managements in Malaysia and Indonesia. But it's not important to do, because we never will, the payroll of GE in America. So this actually reflects, again, the execution of the strategy, and again reflects growth across those emerging markets.

This I think is an interesting opportunity, and apologies to Price Waterhouse whose slide this is based on. The World Bank actually did a piece of work about four years ago on what it said was South to South flows, their geography obviously wasn't that great, but South to South flows were effectively emerging markets to emerging markets and we'll see if the World Bank's equator sits somewhere else. But, in essence what they're saying is there is a block emerging, driven really by China, and it kind of flows through Asia Pacific, through Africa into South America. And if you think about it this block has everything you need. It's got great consumer markets in the Middle East, China, India, Brazil and Indonesia. It's got manufacturing, China, Brazil, Thailand, Vietnam, it's got labour, in huge size. China, Vietnam, Indonesia, India, Brazil. Natural resources South America, Africa, Indonesia. Oil, Middle East, Africa, Venezuela, Kazakhstan and Indonesia. And massive amounts of capital in China, in Singapore, in the Middle East. So this is an economic block that actually isn't relying on the US recovery and isn't really relying on the European Union recovery because actually emerging market businesses has historically been North to South, if you think about it.

If you think about the picture it's really been about Europe investing down or America investing down. We think over the next period there will be a significant opportunity for actually emerging markets to emerging markets. And it's both going to be capital and trade flow. I mean trade,

emerging markets to emerging markets within this block, and these are World Bank figures, grew by 22% in 2005-2007. Emerging Markets to Emerging Markets developed flows grew by 15, and developed to developed, by 10. So the biggest delta was emerging markets to emerging markets, it's logical, we're all aware of the fact that China is doing deals in South Africa to get minerals, we're all aware that China is doing deals in the Middle East to lock into long term natural gas. And, again, even if you take the population of this group, and it's actually 5.6 billion live within this green circle, and let's assume that maybe 300 million of them have high spending power and will be involved in financial transactions, that's another United States. So there is a big opportunity to play for here. Which banks are well positioned? HSBC, Standard Chartered and the Chinese Banks, ICBC, Bank of China, these kinds of guys.

So there is an interesting dynamic here which is outside the conventional North to South thinking, which we think presents opportunities for us. And that's the kind of left hand block on the impact of this crisis is, this crisis will create new trading blocks, you won't get a peace time that looks like it was prior to the financial crisis. Trading patterns have changed, there will be less reliance on Europe and the United States. Now the other three, obviously, are really all around the same thing, which is the government have had to bail out the banking system, and the financial recovery that we've seen to date is as a result of actions that governments have taken. If interest rates go to zero it creates an enormous amount of liquidity, that flows into equity markets, it flows into China, into real estate markets. It's unclear to us that if you took all that support away whether the economy would continue to show some of the resilience that it's shown so far this year. I kind of doubt it actually. So we are going to have an era of very significant increase in government intervention.

One of the things that we have now started to spend a lot of time doing at HSBC is lobbying both here in Brussels, in Paris, in Berlin, and in the United States, to try and make sure that there is at least some sense that some of the very well meaning, very well intentioned proposals that numerous politicians and regulators have put together are at least debated for their end impact, and debated in terms of the unintended consequences. At the moment there's no end impact analysis of the cumulative effect of CRD three and four, the revisions to Basel II, Obama's suggestion this morning that large banks should hold more reserves, Turner report, Walker report, etc. And basically what the incremental cost to the economy will be when these additional costs are in the banking system. Because by definition this will get passed on in pricing. So no one's done a cumulative end impact analysis. Of course one of the reasons is, one of the reasons we're in the pickle we're in, is there is no international framework to do this, which of course is why you've got the risk of the retrenchment from globalisation. There is likely to be an arms race by regulators to trap capital within their country and that's as likely to cause a push back from globalisation as anything else.

Actually, curiously, our structure is probably the least affected by that because we run a holding company with separately capitalised banks already. Again something that we were heavily criticised for, being inefficient, but I kind of think that's the way regulators will look to go, because that's one of your living will solutions. If HSBC got itself into difficulty, who would take it over? Will it actually be broken up? The UK bank would be taken by the UK government, China would take the Hongkong and Shanghai Banking Corporation, and ADIA would probably

take the Middle East operation. So actually we are set up in the way that a lot of regulators are starting think how would you deal with someone too big to fail, too big to save? Well actually you get them separately capitalised with a holding company so you can break it into pieces if it came to that situation. But that will have a huge friction for some of our competitors who are set up as a single legal entity with multiple branches, and they're going to find that capital will get trapped, and it will get trapped for a very logical reason. Lehman Brothers, obviously sitting in this building, obviously from what we understand from newspaper reports sent its money every night back to New York, so there was none here in the US.

In Hong Kong and Singapore the governments have guaranteed the entire banking system. Actually, if Westpac, to pick on someone neutral, failed, there is no money in Hong Kong, so why is the Hong Kong government guaranteeing all the deposits of WestP? It's now got to go to the Australian government and say, could you send some capital in? So what's it going to do? It's going to say you need to set up a subsidiary separately capitalised here, then you're part of my deposit insurance scheme, if you don't do that I'm not going to insure your deposits. Actually your bank will have no funding. So the whole thing will become quite circular. Because why am I putting my taxpayer money to actually insure your deposits when there's no capital in my country? So they're all going to go the way Malaysia went. The case study of Malaysia after the Asian crisis: everyone in Malaysia that is a foreign institution runs a capitalised bank. Our bank in Malaysia is a separate bank with capital. Actually same as the China operation as well. Is it time for me to finish off?

CH In the next two minutes, three minutes, yes.

PG Perfect for questions! So, rushing quickly through this, this just shows you again in more detail and really just makes the point that the financing part, these are all Bloomberg tables, so these are not doctored, these are straight up Bloomberg. So, again, proof that the finance piece is working and that this is not just a single piece of off the balance sheet management revenue, there's a big sales and trading business here. In the Federal banking arena the payments in cash management business, we have picked up in global markets and global banking significant cross border flow. The strength of our business, and when we talk about emerging markets we should probably explode that idea just to say it's really about linking emerging markets to each other and to the developed world. It's actually cross border. It's not about being domestic. So this is not about being huge in Malaysia, it's about getting able to get Malaysian companies to access capital markets or French companies that are building in Malaysia to get financing locally. International connectivity is key to our business proposition, and that's why things like payment to cash management security services work. Because Securities service is providing access to the Korean market for an investor in France. Payments and cash management is doing payment and cash management in Malaysia, Indonesia, China, Hong Kong. So it's connectivity that's actually key to the whole thing. So we're seeing significant market share gains. Actually particularly in PCM, which is interesting because it's the most sticky thing, and it's mostly at the expense of one American institution and one UK institution actually. Again, where the CFOs, and these are European and American CFOs, are effectively saying I've got to have my payment and cash management with a bank that I know that's going to be in Indonesia, in Korea, in Mexico, in

Brazil, because the friction to me of having to re-establish all my PCM relationships every five years is just too much for me to hassle with.

Balance sheet management we've talked about at various result sessions. It will undoubtedly decline in the second half of 2009. The very big increase is amplified in the second half of '08 to the first half of '09, because the second half of '08 we had a number of bad debts sitting up on this line because a number of banks failed. The Washington Mutual where the senior bond holders were crammed down, the Icelandic banks, etc, depressed the second half of '08. In other words you would have seen a much more straightforward progression, first half, second half vs first half of this year, because the second half the purple half's got some debts sitting in it.

This number has still got some juice in it, it won't decline entirely but it will decline because these were positions that were put on in 2007 because we felt the central banks would have to cut rates. So we bought two year bonds, basically, that actually mature in the second half of this year. Now, it won't decline entirely because the yield curves are now steep, but it won't maintain at the current level and the reason for that is if we quickly think this through, if interest rates are three month rates are 50 basis rates and two year rates are 100 basis points, I can earn 50 basis points if nothing changes. But I'm obviously earning that 50 over two years. If the Fed cuts rates 50 basis points it does it that day. So therefore the velocity and the amplification is much greater with absolute rate moves, which are clearly now behind us. You've also got to look at the fact I can't keep positioning this for rates going lower, they can't go negative. So we can't sit here with a massive amount of risk on expecting the US to make rates negative or the UK to make rates negative. Because once rates start going back up this BSM number could fall and you'll all recall that in the '04, '05 period when the Fed last raised rates this fell significantly. What we're trying to do there is to manage a glide path where central banks turn and raise rates, if we manage it and manage it well it won't have a big negative impact and at the same time PFS and CMB will come back up, because there will be a value of funds to our deposit base. And at the same time then global banking and markets, asset management, security services, payments cash management, principle investments will come back up. So we're trying to manage the turn of an interest rate cycle. So therefore we can't stay fully at risk with the same amount of VAR on, on the other hand it won't drop entirely because there is some steepness in the curves. Asset management, again, is a business that will recover and has already started to recover as recently markets have moved up. This is just a statement of why I think the universal banking model, we think the universal banking model works. One of the reasons our global banking markets business has done well is because of the strength of the HSBC group. If we were a standalone business I don't think we would have had the market share gains that we've had in the first half. Because we stand within such a strong financial institution the halo effect is tremendously important to the business.

Just two last things to pick up here, which I think are important, and then the last slides are kind of a motherhood and apple pie statement. We have into the prime services business, we've not done prime brokerage before, this is not full prime brokerage so we're not offering ten times leverage and so on, but we are actually pushing on an open door. We've seen a number of hedge funds have moved their accounts to HSBC because their main concern is getting their money back. Because we've got a large security services business we can clearly operate with

segregated custodian accounts. We've therefore created a joint venture between the markets business and security services so that we can give people leverage in a segregated account so they don't have a re-hypothecation risk that clearly came out when Lehman Brothers failed. And actually there's a significant opportunity for a new revenues industry in here because most hedge funds are now as concerned about the certainty of getting their money back as they are about the leverage they can get against that service. And that's as big a question when investors are talking to them as it is about the performance of the portfolio manager,

The operation infrastructure point as well, and the reason I've brought these two out is to move the dial these are kind of \$500 million type of revenue or expense savings two, three years out. So therefore they will have a significant impact. The operation infrastructure one is this is, we settle bonds and equities in global markets, we settle bonds and equities for other people in security services, we settle bonds and equities in asset management, we settle bonds and equities in private banking. It's not beyond the ken to work out that if we actually did it once rather than four times... So we're working on actually a major project to try and overhaul and create wherever we can, one large engine that settles everything, that looks the same irrespective of which part of the HSBC group is doing it. And that has a significant potential cost saving. And that significant potential cost saving comes about because we have been shaving costs, you can see that in our cost line, we've taken actually about 3,000 people out of the business over the last 18 months. I don't want to keep shaving people out of the business because eventually my revenues drop, so I need to reengineer the business, which is what this cost piece is. Thank you. Perfectly timed for that one nano second question!

CH Thanks very much Stuart. In the interest of time I'm going to cut off the one nano second question and move ahead with the next speaker! Thanks very much.

PG I'm meeting a number of you for a one on one session anyway. Thanks very much.

End of audio.