Edited transcript

Post-Interim Results 2014

Meeting with Analysts hosted by Iain Mackay, Group Finance Director

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Corporate participants:

Iain Mackay, Group Finance Director
Russell Picot, Chief Accounting Officer
Jane Leach, Head of Group Regulatory Information and Analysis
Rob Irvin, Head of Group MI Reporting
Nick Collier, Head of Group Investor Relations

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Good morning and welcome, everybody, to the Post Results Analysts Meeting. With us this morning, we have Iain Mackay, Group Finance Director, we have Russell Picot, who's Group Chief Accounting Officer, and Jane Leach, who's in charge of regulatory reporting. Before I hand over to Iain, just to remind you the housekeeping points, when you want to ask a question, please can you wait for the microphone and can you identify yourself and your house? We do have some lines in from Hong Kong, so we will take calls when they are arriving from Hong Kong. So, Iain, over to you, please. Thank you.

Iain Mackay

Good morning or good afternoon to everybody in Hong Kong. Good morning everybody here in London. Right, I'm sure you've had a chance to work through the numbers a little bit by now. You probably don't want to sit and listen to me talk again. You probably did that more than enough on Monday, so, look, happy just to launch into questions, either from anybody here in the room in London or from your counterparts in Hong Kong. As Nick mentioned, I've got Russell and Jane here with me as well, so we can – if the desire grabs you, we can dig into a bit more detail on some of the capital topics or any other matter. So, look, I'll just open it up to questions and take it from there.

Michael Helsby, Bank of America Merrill Lynch

Just a general question, really. I think I sensed clearly revenue growth has been an issue for the Group as you've been de-risking and selling stuff and competition etc. But it did feel like there was more than a hint of optimism in your positioning in terms of looking at interest rates and talking about the outlook for the second half of the year. So I guess the question is: was it right to detect that, or had you just sort of had more than two Weetabix on the conference call, or is there a change? Are you seeing a change in the revenue outlook?

Iain Mackay

So, look, I think there's been a great deal done in terms of reshaping the Group over the course of the last three and a half years, and, when you do look at the underlying revenue-generating capability of certainly the Commercial Bank, Global Banking and Markets business in the current environment, it's there. The Commercial Bank has had a good first half. The Global Banking and Markets business performed well in difficult trading conditions, and I think when compared to its peer group stands up well in that comparison. As you will have noticed, a great many of the dispositions that we've done over the course of the last three and a half years have been quite particularly focused on Retail Bank Wealth Management, not exclusively, but a lot's been done in there, and I think it would be fair to say that, when we look around some of those businesses that we want to retain that we see – if you like, countries of operation that we see as being important for the long term, when you look at the reshaping of businesses inside those, the concentration of the effort tends to be – not all the time, but tends to be in Retail Bank Wealth Management.

And also, within Retail Bank Wealth Management, we've obviously introduced changes to incentive schemes, both on the credit side as well as the wealth management side, and that has – we've experienced – I mean, we have experienced – and certainly in the Latin American businesses, Brazil and Mexico, we've experienced some headwinds coming from that, and as a consequence of which we'll test some slight modifications to those incentive schemes to try and get the sales force more aligned in terms of the practice that we want, but not completely out of line with local markets.

But I think some of the real pessimism that others felt that I'm not sure we ever felt about China, about Asia, is perhaps moderating somewhat. The ability for the Chinese Government to take actions which support growth over the longer term in China I think is now beginning to filter through, because there's evidence to suggest that's the case. So, we were never particularly bearish on China, I think perhaps the rest of the market is becoming a little bit less bearish, although concern perhaps remains with respect to the degree of transparency around certain activities within financial services.

So, based on the work that we've done, I think it's reasonable for us to be somewhat more optimistic, but also, equally, cognisant of the fact that we're sitting at – in the zero band from an interest-rate perspective. We've been there for a long time. Yes, there's some optimism about possibly seeing rates coming up towards the end of this year in the UK, in the sterling bloc and possibly in dollars sometime next year, and that clearly would be beneficial to an HSBC perspective when you look at the construction of our balance sheet. And, in the meantime, we've got businesses in the UK, in Hong Kong, in parts of Asia, in the Middle East, Canada, that are performing well and are doing reasonably well in the marketplace, operating within the risk appetite.

In fact, I think certainly from a credit and traded-risk perspective, we'd encourage them to use more of the risk appetite, because we're not using all of it, and making sure that the teams understand that that is a possibility for them, that they've got capacity to take more risk in credit and traded market risk. Not from a compliance perspective, and I think that's the important point that Douglas was trying to make, was making sure that our teams understand that, yes, it is sometimes harder work and takes longer to get to know customers, to be satisfied from a customer due-diligence perspective that we can do business with them, but it's worth doing that work if we've got the credit risk and market risk appetite for those customers. And that's the important distinction that we need to make: the difference between not having an appetite for compliance risk, but having an appetite to do the work, to get comfortable that we can serve customers, and that, when we can do that, we've got the capacity, both from a credit and market risk perspective, to do so and to do so well.

So, look, all – there is a lot of things still to do in the Group, and Stuart talked about some of those in terms of reshaping the Brazilian Retail Bank Wealth Management, reshaping part of the Mexican business; obviously a market which we used to think was very promising, like Turkey, is perhaps a little bit less promising in the current environment. So there are things around the Group which we all recognise we still need to do. We've still got work to do on the financial crime front. We've still got work to do in reshaping some of our businesses. We've still got work to do in streamlining and simplifying the technology and the process platforms within it, but that's part of running the Group. That's just part of day-to-day work within the place, but there's enough that we've done, and there's enough going on in the world, for us to be somewhat more optimistic.

But I think I would only temper that in terms of getting really carried away for quarters 3 and 4. You track back as many years as I can track back in our results; there's second-half seasonality in our numbers, and I think there's second-half seasonality in virtually any bank's numbers that's got a remotely similar construct to our own, so, if that helps sort of clarify the tone, okay?

Michael Helsby

Just one follow up. I asked on the conference call about the constant-currency, quarter-on-quarter loan growth, and I don't think you had the numbers then, but I wonder if you –

Iain Mackay

It was 4%.

Iain Mackay

It was 4% constant-currency loan growth.

Michael Helsby

Was it?

Iain Mackay

Yes, in the round.

Michael Helsby

Quarter on quarter?

Iain Mackay

That was annualised, though.

Michael Helsby

Quarter on quarter.

Iain Mackay

So it was 25 billion in dollar terms, and I think in percentage terms I think it was about 4%, wasn't it, Rob?

Rob Irvin, Head of Group MI Reporting

I think so.

Russell Picot

The adjusted currency number, Michael, is broadly US$25 billion.

Participant

Is that December versus June?

Rob Irvin

Quarter on quarter.

Russell Picot

Q1 to Q2.

Iain Mackay

It is 25 billion.

Michael Helsby

Right, okay, thank you.

Manus Costello, Autonomous

Hi, it's Manus Costello from Autonomous. Just to move down the P&L and touch onto cost, there was also an elevated cost performance in Q2, the highest cost performance for a while. I was a little bit confused as to how much of the spend that you put in in the quarter should be regarded as one-off, particularly on the compliance side, and how much should be ongoing. I mean, have we now stepped up to a quarterly run rate of underlying costs of over 9 billion, or was some of the stuff you're talking about one-off investment in systems? Thank you.

Iain Mackay

So, within the quarter in terms of one-off cost, I think it would be fair to say there was – well, I don't call them one-off anymore, but we've obviously got the recurring expenditure, albeit at a much lower rate with respect to customer redress within the UK, but, outside that, there was obviously the UK Financial Services Compensation Scheme levy, which was 121 million. There is a higher run rate within compliance and risk spend within the Group, and we talked about that in terms of looking at an annualised – well, I'm not sure annualised is right, because I'm not quite sure we've achieved steady state yet, but looking at an annual step-up in compliance spend to somewhere between 750 and 800 million, which, when you compare that to 18 months ago, is about 30% higher. When you look at headcount, it's about 30% higher as well. There's been a very significant investment in that over the course of the last two years.

With respect to improvements in the technology that support the sustainability of that – of those compliance processes, it is equally true to say that there is more to do in that space of an investment nature. Some of that investment will be taken over the course of a number of years, but will be not just – not a step-up in expenditure, but an investment that's got enduring value for the Group. In terms of the investment in people, I think it would be fair to say we're getting closer to the point that I think we feel we need to be in the short term to make sure that we implement global standards effectively and consistently around the Group, and certainly, when we talk about this with Marc Moses and his team, he looks at this as a little bit of a bell curve where we're working our way up to the top of that bell curve at the moment, and, as we get the technology in place, the processes embedded and working effectively, we'll see some step down as we get over the top of that, but we're not at the peak yet. I can't give you a precise number as to what that represents, but I think we're considerably further through it than we – we're nearer the end of that process than we are at the beginning of the process.

I think from an overall cost perspective, a couple of years ago we'd put out a very, very broad guidance of sitting on our cost base of somewhere between 8.6 to 9.2 billion a quarter from an expense perspective, and I don't think we're that far off the mark. We were a little bit above that this quarter. There continues to be impetus around simplifying, streamlining the Group, generating saves, both from a sustainable – which would be a gross save perspective, but also an increased focus within the Group in terms of driving net saves, so saves through the bottom line, and there's absolutely no relenting on that effort. If anything, the effort is stepping up, recognising that part of what we've got to do is ensure consistent delivery for the global businesses, supported by the global functions across the world, and that we need greater consistency within that, and there's a lot more work to do.

So I'll go back to some of my earlier comments in response to Michael's question. There's been a lot of reshaping of the portfolio, but, within the Group, in line with the strategy, which is exactly what Stuart talked about on Monday, there's three elements here: obviously, grow the businesses and dividends; obviously implement global standards; but simplify and streamline what we do, and there's a lot to do in that respect. There's more opportunity which we'll capture in the second half of this year, and that effort will continue into 2015 and beyond.

Manus Costello

Do you think you'll achieve positive jaws this year or next year?

Iain Mackay

I think it's unlikely for this year.

Manus Costello

Thanks.

Ronit Ghose, Citigroup

Can I just follow up on Manus's question? Ronit Ghose from Citigroup. Can I just follow up on Manus's question on costs? A lot of the cost increase in Q2 quarter on quarter happened in this region in Europe and it happened in RBWM and GBM, and, stripping out all the notable items you've flagged and one-offs and FSCS and so on, it looks like the underlying – if there's such a thing – is up about 10% in Retail and in GBM Q on Q in Europe. Iain, how much of that is global standards and compliance and so on, or is there something else as well going on in there in the second quarter that I might have missed?

Iain Mackay

So, when you pick up Europe, that picks up headquarters. A significant amount of step-up in spend in the first half of this year, one, related to global standards within the risk and compliance functions, and, in addition to which, a broad base – to a much more moderate extent but increased resources deployed against other regulatory matters, for example stress testing for the PRA and the EBA. So, again, when you come back to streamlining and simplification, there was a – I mean, I can't even begin to describe the degree of effort put in by the business, the risk, the finance teams to deliver several different stress tests over the first half of the year, and incremental spend put in place to support that, but part of the focus – if for no other reason, to make this bearable for our teams – is streamlining and simplifying how we do that going forward.

Ronit Ghose

And would there be an element in the second quarter that you could at all call one-off in that up 10%, or is this really a new base?

Iain Mackay

Yes, FSCS.

Ronit Ghose

Sorry, except for the 100 million odd.

Iain Mackay

Okay.

Ronit Ghose

So it looks like it's up – both Retail and GBM up about 10% Q on Q.

Iain Mackay

So, within Retail Bank Wealth Management, it's been very much about compliance and global standards in Europe.

Ronit Ghose

Right.

Iain Mackay

At the Group level, again, that's been much of the focus in the first half.

Ronit Ghose

Alright, and just one last question. You said compliance headcount and costs were up about 30% in the last 18 months, I think you said. Are there…?

Iain Mackay

Headcount is, yes.

Ronit Ghose

Headcount is. Are there specific…? What gives you confidence that you're nearer the end of this process than the beginning? I mean, if you were being cynical, you'd say this just seems to be an ongoing… Many of us round the table work at big global banks, and it's just an ongoing global growth.

Iain Mackay

Anecdotally, I could tell you I receive much fewer requests for headcount increase from the risk functions.

Ronit Ghose

Okay.

Iain Mackay

Okay, much fewer on a weekly basis, daily basis, and, no, where we are is in line with the plans that Marc and the team set out a couple of years ago in terms of what we need to do. That plan's fairly dynamic, because what we need to do tends to evolve as we learn more about embedding some of those processes, not just within headquarters in Europe but within our businesses around the globe, but where we are from a headcount perspective is approaching the levels that were anticipated from a plan perspective.

Ronit Ghose

Thank you.

Iain Mackay

Okay, Sandy.

Sandy Chen, Cenkos Securities

I just want to ask, actually getting back to Mike's growth question, on the face of the balance sheet – and I asked this on the call as well – the reverse repo item, really, if you just look on the face of the balance sheet, accounts for a lot of the balance-sheet growth. I mean, how…? I was just thinking, trying to put that together with what's likely to happen to the yield curve environment, whether or not it shifts up or flattens with base-rate rises. I mean, is there…? Can you just help me in terms of thinking about how that might translate into higher income, and was that an intentional – well, obviously it was an intentional, but is that increased allocation to reverse repo a part of the growth strategy.

Iain Mackay

No, it's a reflection of customer activity and how we finance security transactions. It's a reflection of activity within the Global Banking and Markets business principally, nothing more, nothing less. There's not a particular strategy as it relates to repo, and the changes that Samir and the team put in place at the end of 2013 was just a reflection of the behaviour of the portfolio and how we managed it.

Sandy Chen

Right, okay. Alright.

Iain Mackay

Okay.

James Chappell, Berenberg

Yeah, James Chappell from Berenberg. Two questions, really, which are sort of related. One was the – you initially were talking a lot more about growth, and how are you balancing that with the return-on-risk-weighted asset targets? They seem to have gone to the background a little bit, and growth seems to be being pushed more as a target going forwards. And then, I suppose, the second question relating to that was your comments. How does that growth balance with risk appetite with the outlook for provisions? And it seems to be that – you know, you mentioned that you're keen for – various parts of the organisation aren't really using all of their risk appetite, so how are you, I suppose, balancing all that together at the moment?

Iain Mackay

Focus on returns has not gone to background. I suppose within an hour's call, we can't talk about everything all the time, right?

James Chappell

Yeah.

Iain Mackay

But the businesses are tasked to grow their business in line with returns, and there are return-on-risk-weighted-asset targets established for the businesses in line with a triangulation to a return-on-equity target for the Group of 12-15%. Now, that return-on-equity target was established based off a 10%-ish common-equity-tier-1 target. We're obviously operating at above that level, nonetheless having generated a 10.7% return on equity annualised in the first half off a much higher equity base. But the businesses, in terms of writing business on a day-to-day basis, are challenged to have a set of targets that they work towards, and those targets operationally has been return on risk-weighted assets.

That's entirely consistent with growing the business, and it's entirely consistent with managing risk appetite. It's – you know, this isn't multidimensional. It's just part of running the business, so it's not a change in focus. It is growing the business profitably. It's not, 'Let's go put tonnes of assets onto the balance sheet and then find ourselves tanking on the returns equation.' There's a set of targets out there, and that's what we discuss on a monthly basis in the Group Management Board and then the risk management meetings, which we have every month, and monitor the business performance against those targets.

James Chappell

And then the outlook for provisions… Sorry, and then the follow-on is what you seem to apply on – imply from the call was that, effectively, because of that process, we should expect provision numbers to keep coming down, and the provision charge outlook –

Iain Mackay

I don't think we said 'keep coming down'. Don't really want you to put words in my mouth in that respect. Good try, but it is past nine o'clock, so I have woken up this morning. So I don't think they're necessarily going to keep coming down, but, again, I think – Stuart made a few comments on Monday about some very deliberate de-risking that took place in the business, not only from a composition of the portfolio standpoint but also the nature of some of the composition of the credit risk that we take, who we take that credit risk with, and, when you underwrite lower risk credits, principally from a movement more to secured risk, the yield on that tends to be lower, but part of the compensating factor – and certainly our experience on that thus far has been that you get some of that benefit coming through your loan impairment charges line as well. So, again, there's a reasonably consistent approach to that. There are some markets in which we are looking at the way in which we serve customers in the Retail Bank Wealth Management space, where, to be effective competitors locally, we probably need to do more in the unsecured lending space at a personal lending level, getting the right scorecards in place, the right collection capability in place; again, knowing your customer is important in that regard.

That almost – as we build into that, as we test our way into that in a few markets, we'll almost certainly see some of the effect on that on the top line, but I think we would be equally – at least from a dollar perspective, we'd likely see higher loan impairment charges coming through, but, on a risk-adjusted basis, we'll test it based on the returns. If we don't get the scorecard right and the losses are higher, then that's going to show up in the returns, but we're going to test our way in to this, in those markets where, frankly, to be effective, to compete, we probably need to do that, and there's a particular focus – and it is at a very early stage of development, but there's a particular focus on that, for example, in Brazil and Mexico.

But, when you look across the portfolio, there aren't obvious black spots from a credit risk standpoint. Within the Commercial Banking, Global Banking businesses, it is what we do. It would be normal to expect a couple of large credits to require restructuring and provisioning, and, again, we've seen some of that in the first half of this year. We see it in every quarter, but such incidents are low in frequency, and, when that restructuring does take place, we've had a reasonably good success of restructuring and seeing some of that recovery is coming back at a later date as the health of the company improves and as the payments come back. And we saw some of that in Commercial Bank in the first half of this year, and we saw some of that in the Middle East as well, and some of that goes back to restructurings that were done in 2010 and 2011, for example.

So I think, on the loan impairment charge line, I think it would be fair to say that there's a reflection of some of the de-risking. There's obviously a reflection of the continued runoff of the US portfolio, and the improvement in the housing market related to that. There's benefits coming through from improvement in the economy in the UK, and that was most evident within the Commercial Banking space in the first half, but, in the round, when you go through some of the – if you like, some of the socio-political trouble spots of the world, the book quality is holding up fairly well, which I think is testament to the works done by the team. But I wouldn't bank on the loan impairment charges continuing to decline a great deal. I think we will see that in the US portfolio, but, frankly, of the total loan impairment charges we took in the first half, it was only just over 100 million that came from that portfolio. So, out of 1.8 billion, it wasn't – you know, it was less than 10% of that.

Christopher Wheeler, Mediobanca

Yes, Chris Wheeler from Mediobanca. A couple of questions. First one, Argentina. We didn't actually talk much about that on Monday, which surprised me, because I forgot about it, but it had a pretty good performance in the quarter, in Global Banking and Markets –

Iain Mackay

Foreign exchange income.

Christopher Wheeler, Mediobanca

Okay, so – foreign exchange income – so the question, I suppose, given that Brazil and Mexico are your core businesses, I guess – that's the way I view it – I mean, what issues, if any, are you facing because of what's been going on in Argentina since the end of the quarter?

Iain Mackay

No, look, from a restructuring perspective, we're not particularly exposed to the default that's – the partial default, whatever you want to call it – that's going on in Argentina. The team that we've got in place in Argentina I think is possibly one of the best we've got in the team. They've got a relatively small, relatively simple, straightforward business that they're working. Here's a team that – many of them actually lived through the crisis at the beginning of the 2000s and went through the recapitalisation of that business. Here's a business that is generating a return on equity above the target range for the Group, with a – I would say a fairly moderate risk appetite, and exposures to corporate clients, and this is principally a Global Banking and Markets business, but, even then, the Commercial Bank and the Retail Bank Wealth Management businesses are reasonably well formed and functioning well, but it's principally a Global Banking and Markets business that we run in Argentina, and it's principally focused on facilitating international trade.

Now, the step-up that we saw in revenues in the first half was on the back of, as you saw, some significant movements in the currency, which benefited us from a foreign exchange perspective. The business performs well; it's well-formed; it's at the scale that we want within Argentina. You always sit and look at it and say: country with massive potential, unfortunately a rather difficult political environment, but we've got a business that – I think it would be fair to say it's an international bank with absolutely the best reputation on the street in Argentina, and we sort of live in hope that the potential of the country will be realised at some point, and we will clearly participate and benefit from that, but it's difficult to say when that might be.

Christopher Wheeler

Okay, thanks very much, and the second question really is on whether you can give any clue as to where you are on CCAR following the comments about your stress-testing activity, and just improving those procedures. Perhaps just give us a clue as to whether you now feel comfortable with that. I know that, at the end of the day – I think you said to us, I think last time, it's impossible to know what the Fed actually wants, so you have to just do as much as you can and then cross your fingers that you've done it, but where are you, if you can tell us anything? And, secondly, I suppose, you said you were the best capitalised bank, I think, in the last CCAR round.

Iain Mackay

Uh-huh.

Christopher Wheeler

Is there anything major you need to do or feel you can share with us regarding the FBO, or is it just really a fact of just tweaking round the edges, given you have a lot of excess capital there already?

Iain Mackay

Yep, so the US stress-testing breaks down into two parts. There's DFAST, which is the Dodd-Frank Act Stress Test, and that's a quantitative test, and we were, out of the 30 banks stress tested, the ones with the strongest capital ratios at the end of that, and that is by virtue of the fact that some of the restructuring we've done, the dispositions we've done in the US – the capital, as we've discussed previously, is trapped within the US, and explains why we're sitting on such strong capital ratios there.

The second element of it is the CCAR, and that is very much a qualitative exercise, where the reasons for failing – and none of our capital actions, by the way, were rejected by the Federal Reserve, but they saw elements of the process that they would like us to improve – areas of modelling, certain types of risk – and it is very much a model-driven approach. So we are working on the process elements. We have engaged external consulting help that has worked with a number of those banks that were successful in passing CCAR last time round to gain a better insight as to what they've done and what we may need to do to come up to those standards, and the team is working on it.

There are a lot of resources being put at this, but I think a fair balancing comment would be I have conversations with the CFOs of some of the larger US banks, and I think it would be fair to say that, when we all have a chat about what we think we need to do to get to CCAR, some of those that passed last year are not entirely clear as to what they need to do in 2015 to pass. What has been confirmed to us by the Fed is that they will not require us to do a mid-term resubmission to them of the 2014 stress test, but the resubmission will actually be our submission for 2015, which will be done in early January of next year, which was encouraging, I think. Again, I should not, would not put words in the mouth of the Federal Reserve, but they recognised that, given the capital position that we hold, it probably wasn't going to be terribly productive to go through a major resubmission process, but they've made very clear to us some of the areas of improvement, from a qualitative perspective, that they would like to see from us, and that's what we're working on.

Christopher Wheeler

And in terms of… Sorry, and in terms of any adjustments within the business, presumably that's not –

Iain Mackay

No, from an FBO standpoint, you know, again, they're looking at really establishing US bank holding companies. We've been organised through US bank holding companies for many years; that's what HSBC North American Holdings is. And, therefore, our finance company – the broker dealer in the Bank in the US – sit underneath that holding company. And it was at that holding company level that the capital was tested, as well as at the Bank level.

So, from an HBO perspective – an FBO perspective, we are – Freudian slip there – HBO – should make a film out of this, shouldn't we? I'm sure somebody will make a film out of it eventually.

Amit Goel

Hi, Amit Goel from Credit Suisse. Just wanted to check also on your Hong Kong based capital requirements, there's just one of the points I saw from Hang Seng Bank, where their capital was impacted by model changes from the HKMA, which were outside of just the mortgage book – just curious if there are any other broader changes happening there, in terms of your Hong Kong based capital.

Iain Mackay

No. The HKMA are implementing Basel III, and a quite faithful implementation of Basel III, and through the supervisory process, test the models within the Hong Kong bank community, and inform changes within that based on what they want to see – in terms of whether it's modelling retail risk, wholesale risk, market risk, operational risk – and there is nothing particular going on, from an implementation –albeit Basel III – perspective, through the HKMA, that's out of the ordinary. And there's certainly nothing odd going on either within HBAP, or within Hang Seng, as it relates specifically to the implementation of model changes. So, no, there's nothing.

Jane Leach

You do sometimes get individual regulators that have specific ways that they like the models to operate and be developed, so that we do end up with some differences around the globe between some of the – the way that we do things in [inaudible] and some things that we do locally.

Amit Goel

Okay, thank you. Sorry, just one other follow-up: just in terms of the stress testing – and obviously that's been an area which has had a lot more cost, and there's going to be a lot more focus as the year goes on – how is that, kind of, integrated across? Obviously there's the US looking at the stress testing. How is the PRA looking at, for example, Asian exposures? How does that, you know, work with HKMA, etc?

Iain Mackay

I'll tell you: our stress testing aficionado is sitting to my right. So we'll let Russell take that one.

Russell Picot

So, the way it's worked this year is that we've had the EBA set all the economic scenarios; the UK PRA's done the UK variance, where effectively we've submitted our twin sets; that included the economic scenarios for Hong Kong and China, which we've run. The PRA is obviously very well aware the HKMA's been carrying out its own programme, and our understanding is that there is a sort of normal supervisory dialogue in progress. Obviously, the PRA's interested to understand the HKMA view of one of our major subsidiaries under stress.

We've made a policy point to our regulator that it's helpful to not have multiple cuts of data and different views of stress, etc. And if, going forward, we could actually line up a process which recognised a local stress test, and built on those, we'd find that really helpful because then we wouldn't end up doing things many times over. I think they've understood that message. It's not where we are for 2014, but it's something we'd like to see them move on in 2015. You know, I think our perspective is that dialogue is actually very constructive.

Amit Goel

Thank you.

Rohith Chandra-Rajan, Barclays

Thanks. It's Rohith Chandra-Rajan at Barclays. I wonder if I could pick up on your comments about the reshaping of the RBWM business in Brazil and Mexico, Iain. I guess what we've seen from the local banks, particularly in Brazil over the last 18 months or so, is kind of the opposite of what you're talking about. So they've been working quite hard to de-risk their balance sheets, seeing, you know, margin decline and also then hoping for a risk-adjusted return improvement. It sounds like you're doing the exact opposite. So, it's, sort of – I presume that reflects a very different start point, in terms of the mix of the retail balance sheet for HSBC versus most of the local peers. So, I just wondered if you could give us a sense of scale on that.

Iain Mackay

Very different starting points; completely different starting points. I think it would be perhaps not an overstatement to say that some of the local banks don't necessarily – in the retail banking space – don't necessarily see HSBC as a competitor, either in terms of the products offered, how they're offered, how they're priced. So, we are from fundamentally different starting points, and we're not, sort of, going down the path of trying to become a Brazilian bank to the mass market, but we are very much about becoming an HSBC Premier and Advanced bank for the Brazilian market.

Some of the reshaping is informed by things that we've talked about previously. I think Stuart talked on Monday about the city-clusters approach around developing a retail banking business in China, for example, and reflecting a similar approach in countries like Brazil and Mexico, where the networks that we acquired through Bamerindus and Bital many years ago were, sort of, peanut butter spread across the country – and re-looking where we need that concentration – or if, in fact, concentration's the right term – but where we need that presence closest to the populations that best meet the demographics that we serve, through the Advanced and Premier offerings.

Frankly, from where the Brazilian bank is starting – and Mexico, frankly – it's got a bit of a way to travel in that respect. But fundamentally different starting points vis-à-vis local competition in Brazil.

Rohith Chandra-Rajan

And is the consumer credit portion of the balance sheet, in Brazil and Mexico, much lower than it is in your other EM geographies?

Iain Mackay

Well, we don't actually, per se, have significant consumer finance businesses in anywhere except what we had in the US – which you obviously have an appreciation of how that's running off – and then a portfolio in Brazil, which is called Losango, which again is going through a fairly significant re-shaping.

Now, when you go and look at the loan loss experience of Losango, it's been quite similar to some of the loan loss experiences that many Brazilian banks have done in the consumer finance space. So, the reshaping of, if you like, the unsecured personal lending offering in Brazil, although it doesn't fall within the Losango space; we've got to revisit how Losango operates from a consumer finance perspective.

Rohith Chandra-Rajan

Okay. Thank you. And then, just more broadly, just your thoughts on credit quality prospects in Brazil – I know you talked, kind of, about the accounting changes that happened last year, and it sounds like they're largely done. I'm just wondering your thoughts on economic prospects, given that that's, you know, perhaps a little bit of a worry, and your expectation from a credit quality perspective.

Iain Mackay

I mean, certainly from a growth outlook, I think our view is that Latin America possibly presents slightly more challenges to that outlook than some of the other regions within the Group. I'm not sure there's a great deal more that I could say in that respect. The loan impairment work that's been done in Brazil over the course of the last 18 months has really been looking at the loan impairment modelling, and making sure that we've got that aligned to Group policy and practice; that we've got some consistency. There was work done on that in 2013; there was some further work done in the first half of this year. Any remaining work will be completed in the second half of this year.

I think our view is that we don't expect to see particularly significant – I think we will see some impact from the completion of that work, which is just aligning to Group policy. We don't expect it necessarily to be that significant in the overall picture of our loan impairment charges.

But, economically, the picture in Brazil has actually been very steady, when you exclude the effect of the model changes that we've implemented over the last 18 months.

Rohith Chandra-Rajan

Thank you.

Chirantan Barua, Sanford C. Bernstein & Co

Hi. Chira from Bernstein. First question, Iain, is on the CML portfolio, and if there's any update on the disposals that you guided to at the beginning of the year and what is the outlook for the next, kind of, 12 months?

The second's on BSM: is there an updated guidance, given H1 performance and the yields that have picked up in sterling?

The third one was much more broader comment on your risk in the book, right? So, you've stressed massively that there's been a huge amount of de-risking; this has happened in the last three years. You've got a uniform set of stress tests that you've been running for the last four/five years. How does it reflect, if you look at the same way you stress credit risk and market risk, two years back, and the way you do it right now? So, any colour around that? Because it's easy to say that you de-risked the book, but is there any tangible output that we can see?

Iain Mackay

Well, we'll talk about that one last. Again, maybe Jane and Russell will provide some insight on those. Sorry, your first question was?

Chirantan Barua

CML.

Iain Mackay

CML, right. Look, again, that portfolio sits overall – unpaid principal balance sits about 27.5 billion. That's down about 8 billion, compared to the same point last year. Of that, a little bit less than half was dispositions of portfolios. So, in the second half of 2013, we completed the sale of defaulted loans – so, those which were either in or entering a foreclosure process. That was very successfully completed by the business. I think, actually, on July 1st, we completed the first sale of defaulted re-performing loans. We delivered it under exactly the same process, so, competitive option – good pricing on it; actually sold those loans at slightly above book value, I think, which is the first time we've actually realised a sale above book value in that portfolio.

So although we noted it in the interim report, it wasn't reflected in the results, because it was competed in the beginning of July, so it'll show up in the third quarter's numbers. In the second half of the year, we will market an additional two tranches of defaulted loans. The buyers are the usual suspects. There's good appetite for this; that's reflected in the pricing.

Excluding dispositions, the run-down speed has slowed. You know, the re-financing opportunity for most of these customers remains very, very limited – if, in fact, it exists at all. And because of the extent of modifications within the book, there are – relatively for that type of credit – lower rates of interest in any case. So, I think from a run-off perspective, it's reasonable to assume that the rate of run-off will slow somewhat, and when I say that I mean charge off and pay down. But we will continue, just as the market has appetite for it, to continue to sell: performing loans, and to the extent – obviously, we still have delinquencies coming through the book, but a much, much lower rate. So, delinquencies I think at the end of the second quarter were about 3.2 billion, and that was less than 50% of the two plus delinquencies at the same time in 2013. But the actual run-down, from charge off and repayment, I think will slow somewhat over the next year or so.

Chirantan Barua

How is the book funded right now?

Iain Mackay

Same way it always has been: wholesale debt. And that runs down as the book runs down, yeah.

BSM: I think on the guidance point, I mean, you've seen how it's evolved over the course of the last, sort of, 18 to 24 months – very much in line, actually, with the guidance that Stuart has provided. I think the guidance remains the same. So, you know, through the end of this year, we sort of expect to see the numbers, sort of, in the 2.5-2.6 range, and then next year, assuming we got the interest rate increases we talked about in the call on Monday, I think we would expect to see lower income. Because there is – although we see pick-up in the banking books – so, Retail Bank, Commercial Bank, Global Bank – there are offsets within the Markets business, because it gets its funding for the traded positions from BSM. The repositioning of a book that would move to a shorter positioning would, again, probably have an impact of about half a billion. So, next year, you're talking about a number that's probably more akin to a couple of billion, as opposed to two and a half.

On stress testing, I'll put in my two pennies' worth. The stress testing that we've done for the Group this year is an enterprise-wide stress test, in a format stipulated by the PRA and EBA. Historically, we've done stress tests based on an evaluation of where we see emerging risk within the portfolio. We've done very targeted stress tests. We've done them over a short period of time, quickly, focused on particular books of business, particular countries, particular lines of business – and it's then informed what we do from a management action perspective, from a risk appetite perspective.

The stress tests that we've completed for the PRA and EBA was: over 700,000 data sets submitted, in a standard format, according to economic scenarios set by the EBA and the PRA. They are not necessarily the stress tests that we would have applied. So, the outcomes don't necessarily inform us a great deal about what we might do from a management action, or from a risk appetite perspective.

But I'll stop there and hand on to Russell.

Russell Picot

Yeah, no, I absolutely agree with that, Iain. I mean, as you know, the PRA and EBA tests are quite different: one's dynamic, one's static, etc. I mean, I think there's no doubt it's the biggest stress test we've ever done; it's probably the biggest stress test any bank has ever done, not that we're particularly proud to have that particular accolade.

I think when you stand back and we look at this, and you think, 'Did we learn any lessons?', I think it's reinforced a couple of things that we already knew. Firstly, there's some big pieces of HSBC which matter a lot more than some smaller pieces. And I think it just reminded us of – it's quite useful to actually see all the pieces all stressed at the same time. And then you sort of stack them all alongside each other – and, particularly, we went through an exercise of the central team, trying to predict what the outcome would be before we ran the numbers, and then we compared the outcome against our forecast, as it were, and took that through the Group Risk Committee, which they found quite an interesting exercise.

Iain Mackay

It was a draw!

Russell Picot

We were the Germans on penalties! I think that just showed us a couple of things which we were quite aware of, that just said, 'Okay; if you, sort of, had that calibrated in that manner; it reinforces the management actions which we were already taking.'

Raul Sinha, JP Morgan

I've got the mic here.

Iain Mackay

Right, we'll go for you and then we'll see if there's any questions from Hong Kong. Fire away; sorry.

Raul Sinha

It's Raul Sinha from JP Morgan. If I can have three hopefully relatively quick ones. The first one, just following on from the previous question about the NII sensitivity: how useful is this NII sensitivity that you publish? Because, obviously, when you look at the disclosure –

Iain Mackay

I don't know. You tell me.

Raul Sinha

If you look at the way you've calculated that, you've made a number of assumptions. It doesn't seem to me that you have made any assumptions about re-pricing, or behavioural changes within the Commercial Bank. Other banks tell us that we should not be relying on this, and the actual outcome could be quite different.

Iain Mackay

We're saying exactly the same thing. There's no management actions reflected in that sensitivity analysis. I mean, you can – if you just read p. 163 , this is a gross analysis; it's 25 basis points at the beginning of four consecutive quarters, and that's the possible impact. There's no management actions on how we dynamically manage balance sheet management, which we do, but those actions are informed by day-to-day market movements and what the team see as opportunities, in terms of improving the management of interest rate risk in the banking book.

Are there likely to be four consecutive 25 basis points on the first day of the quarter every…? No, I don't think so. But, you know, it gives you a starting point; if you want to go and do more analysis on this, fire away. We obviously do more analysis on it, but it's informed by what we would do from a management actions perspective. But, no, by definition of any sensitivity, it's somewhat artificial in nature. But it hopefully provides the market with some guidance and some quantification as to what possible outcomes there might be.

Raul Sinha

Okay. The second and third questions I've got: the second one is on – potentially any comments on your view on collateral backing commodity trade finance within Asia. Obviously it's a point of discussion for some other banks. Could you comment on your thoughts? There's some press reports, obviously, about various banks looking at exposures there. I'm interested to know whether you think this might have broader implications for trade finance in Asia, and whether you have any exposure there.

Iain Mackay

Not engaged around the Qingdao issues at all and as a consequence of learning about that in the market, obviously from a risk management perspective, we then go across the businesses and say, 'Right, where are the possible exposures?' and look at each of the businesses which would be engaged in those types of activity. Certainly, we've encountered nothing material or significant in that respect. Obviously, again, it sort of heightens awareness around activities such as customer due diligence, perfecting documentation, understanding the transaction and making sure that we've supported each transaction properly.

I think, conceivably, the wider implication is it's another instance – it may just be one pinpoint, but it's another instance of, if you like, from a conduct perspective and transparency in the Asian markets, of just people recognising that there's probably always going to be somebody out there trying to pull a fast one, and you need to be awake to it and you need to have the right controls in place to manage that. So, from our standpoint, the learning for us is: 'Well, okay. Are we happy with our control processes? Are we happy with the understanding of the customers we're dealing with?' You know, I see these emails every day. When these things come up across the portfolio, Mark and his team have comms out to our people round the world saying, 'Look, this has come up in location X. Let's go look at our similar business. Are we happy with our controls? Are we happy with the customers? Where are the exposures?' Where we have such exposures, it informs management actions and, even when it doesn't, it informs a review of internal controls.

Raul Sinha

Okay. And then the last one, Iain, very quickly. Again, there's a lot of movement, a lot of detailed disclosure, obviously, around litigation and the results. I might have probably not understood the disclosure, but it does look like, in June 2014, there was a new lawsuit from New York State for the US mortgage securitisation. Is that new, or does that relate to the existing US mortgage securitisation issues? And you say $32 billion of loss is collateral value for the various counter-parties that have been sued, within the note. How much of that is your –?

Iain Mackay

That was a new case. It is literally hot off the presses. It's, interestingly enough, raised by a bunch of players in the market place, against a small group of banks. And it's far too early in the process, but it's – there's a whole group of banks, sitting, looking at the mortgage space again.

Raul Sinha

This is the New York State filing the case, or is that other things?

Iain Mackay

I'm sorry, which case specifically are you referring to?

Raul Sinha

263.

Russell Picot

This is a disclosure that says the lawsuit was filed in New York State Court, plaintiffs are investors in the Trust that include, among others, BlackRock and PIMCO funds.

Iain Mackay

That's the one I'm talking about. This is a happy hunting ground from a legal perspective. You've got to work through each case, determine whether there's any merit to it. It informs legal strategy based on our internal investigations. What we tell you, we tell you in these disclosures.

Mark Phin, KBW

Morning. It's Mark Phin from KBW. I was just looking, on balance sheet management revenues in particular, on the interest rate sensitivity, just – I think I probably need a simple answer. Is that just internal funding that your funding cost is going up on a short-term basis against a fixed rate book, and then that fixed rate book will increase as you re-invest or you get the revenue back? So, if you like, the drop in BSM revenues is very short term.

Iain Mackay

Well, it's not initially very short term. Again, it depends on how that book is positioned. But balance sheet management is our corporate surplus. So, the activities of the – so, the value funds, cost of funds is transferred at arm's length from balance sheet management to Retail Bank, to Commercial Bank, to Global Banking and Markets – and, slightly lesser extent, to the Private Bank – and they get the value funds and they also get, when they borrow from balance sheet management to support client activity, they get hit with the cost of funds.

So, the impact is simply the repositioning of the book, based on movement of interest rates. Again, when you go back to the nature of the simulation, the simulation is set up based on a very static set of assumptions. And then the balance sheet management teams round the world then, on a daily basis, try and – well, if you were to set it off against the simulation – would try and mitigate the effects of that simulation, okay?

Mark Phin

Okay. So, that would be a permanent drop in balance sheet management?

Iain Mackay

It may; it may not be.

Russell Picot

That'll depend on what they've done to invest the funds, as well.

Mark Phin

Well, that's what I was just thinking –

Russell Picot

The businesses are interest-rate-risk neutral, broadly. Any interest rate risk positioning, effectively, is in BSM, so they will position according to what they think interest rates are going to do. There's at least a short term pull from interest rates rising within BSM, as Iain says, with an offset in the actual businesses.

Obviously, as we – go back over the last three or four years, as we have seen those market positions roll off, they've been replaced at lower yields. So, that process in reverse is what you'd expect to see happening in BSM. You'll be able to re-invest at higher yields as rates move.

Mark Phin

Okay. And then, the second question – I think this is coming back to an old subject – but Bank of Communications, just – your value-in-use went up about 600 million in the first half. Is the simple way to think about this is that you can effectively recognise the retained earnings of BoCom rather than the attributable profit of BoCom? In other words, your value-in-use will go up, to the extent that the – assuming there's no other assumption changes, that value-in-use just moves up by the retained earnings, which seems to be what happens in the first half.

Iain Mackay

You know this model, so fire away.

Russell Picot

So, if nothing else changed, then the VIU will gradually tick up over time because of unwinding of discount, this is a DCF model. And what drives it quarter-by-quarter is that impact; it's the actual financial performance of BoCom because we update that every three months, and also what's happening to the capital position, because there's an explicit capital management charge, effectively marked against the net refunds coming out of that. So, there's a number of moving parts.

We re-calibrate that model so that – the cycle is: we lag BoCom's results by three months; when those results come out, we look at them, brokers tend to update their forecasts; we look at the range of published broker forecasts; we look at their assumptions; that all gets plugged into our model; and we update it, together with our view about whether or not we have a different perspective from the market. So, there are at least two or three things moving every quarter, either all the same way or moving against each other and, obviously, when BoCom pays a dividend, it then – that's probably broadly neutral because it brings down our carrying value, but also takes cash out of the business.

Mark Phin

Okay, thank you.

Chintan Joshi, Nomura

Just a couple of quick follow-ups – just on your jaws comment, you said there wouldn't be jaws this year. Were you talking about reported basis, or underlying and significant basis?

Iain Mackay

Both to be fair

Chintan Joshi

Then, should we expect any hits to our capital from model changes over the next six to 12 months that you've got in pipeline?

Jane Leach

Nothing particularly significant. There is, of course, the IRB Foundation approach, which has come out recently. That supplied primarily to portfolios which already have LGD floors on, so that lessens the impact. So there's nothing significant.

Chintan Joshi

Okay. Then, in terms of run-off portfolio, we talked about CML. On the GBM side, you know, what can we expect there? Is there proactive action being taken there to dispose some of those? Also, for the full run-off portfolio, as it gets smaller and smaller, is there a risk that what's remaining is, you know, more toxic than not?

Iain Mackay

So, on the legacy ABS sitting within GBM, there is very active management of that. So, we launched a project in the fourth quarter of last year, which really got up a bit of a head of steam in the first half, which is focused on moving down the risk-weighted assets concentration within that book, and moving positions out of the book, through market transactions. The team's actually had some good success with that, in the first half. The effort will continue. It's informed by pricing in the market place. These are books of business which, notwithstanding their capital intensity, are performing. You know, if you look, broadly speaking, as an indicator, the AFS reserve, you can continue to see the improvement overall in the position of the AFS reserve, as that becomes less and less and less negative.

So, yes, the effort continues. There's a small team sitting in Samir's shop that basically spend their life working this through. I wouldn't – certainly, when you look at legacy in the round, the truly toxic stuff in CML is long gone. What we're dealing with – again, informed by the fact that two-plus delinquencies are down to 3.2 billion – they're about 7.4 at this time last year – the stuff that was truly toxic went into foreclosure a long time ago and has been sold out of the portfolio. I think what we're going to end up – now, assuming the property market remains reasonably stable and that employment levels remain at or better than they are today, or even with a little bit of a deterioration, that CML book will continue to be fairly stable as we manage it down. That book was actually, through the crisis, very sensitive to employment and underemployment, less sensitive to interest rates. So, even with interest rate movement up from the Fed perspective over the course of the next year, the likely sensitivity to performance and delinquencies – it won't be nil, but it's fairly muted. It's particularly sensitive to employment. So were you to see the US go a little bit pear-shaped from a recovery perspective and unemployment to be impacted significantly, then that would be what would really tell on the performance of that book. But in terms of the real toxicity in that, it's gone.

Chintan Joshi

Good to hear that. Stress-testing – you've done this big enterprise-wide exercise. How does that inform your view on Pillar 2B excess? Does it make you comfortable the 5% should be enough, or, you know – I don't know how you answer that.

Iain Mackay

Nor do I. Look, this is the purpose of the stress test, so the – as Russell described, we've got ongoing engagement with the PRA, which is coming back and looking at portfolio, and the way they're doing the review is they've divvied it up into specialised teams. So there's a UK mortgage team, a retail team, a – so there's about six/seven different teams, specialised areas, which are sort of digging into how the stress test was done and was it stressful enough. And then there's got to be an evaluation made by the PRA, informed, I'm sure, by FPC, as to how they then implement policy around the PRA buffer. The PRA buffer, we believe, is to be the replacement for Pillar 2 or aspects of Pillar 2, but that's the process, and we'll perhaps get insight in December or early part of next year.

Jane Leach

Yeah, they haven't yet set out their methodology for determining the PRA buffer based on stress-testing and other factors, so we are expecting to get more on that towards Q4.

Russell Picot

And we're not expecting – I mean, disclosure timing is EBA, autumn. I think we're not expecting PRA disclosure until later than that this year, so it's relatively late in the calendar for 2014.

Chintan Joshi

Okay. Finally, in terms of cost of compliance, the issue you've raised, is this – or the regulation – is this just the compliance cost, the 10% of employees that you have in risk and compliance? Are you talking about that kind of cost, or are you talking about costs that you'll have to take on in the future: for instance, from issuing various capital securities? Is it heading in that direction?

Iain Mackay

Sorry, I'm not sure I completely understand the question.

Chintan Joshi

I mean, Douglas raised the point that the costs are escalating because of the various regulation. What was he referring to when he was saying that? Because Tyrie's obviously asking now for, you know, quantified, come back to us, and I'm sure he will want specific answers on that.

Iain Mackay

Yeah, I'm surprised I didn't get a visit from Douglas this morning, actually, asking for us to start figuring out the real impact of that. Douglas' point was less around cost; it was more around greater divergence and inconsistency in how regulation's been implemented across different jurisdictions, degrees of extra-territoriality, motivation for people to continue to work within the industry in the United Kingdom – you know, you look at the Senior Persons Regime or the certification regime that's under consultation at the moment. It's the additive effect of whether it's consultation on leverage ratio, consultation on senior peoples' regime, CRD IV compensation, CRD IV capital, CRD IV liquidity, ring-fencing, competitive markets authorities – you know, Competition and Markets Authority's review, and the list goes on. And that's just the UK and Europe we're talking about, right?

I don't think Douglas was trying to make a point about cost, but there's obviously a very significant cost involved with all of that. I would expect a visit from the Chairman sometime in the next 24 to 48 hours, going, 'Okay, hang on, how much is all of this costing us?' We know what we've spent on regulation. I mean, I talked about some of the numbers relating to stress-testing, talked about some of the numbers relating to COREP and FINREP – still don't know what the hell they're going to use those for. And then we can start putting together – we are putting together – what we think ring-fencing could cost us.

The ring-fencing exercise is massive, and there are very few people, in my view, in either regulation or politics, who have got any notion as to how big this is as a project. But when we as a – sort of a group of banks sit around and talk about some of the – and the banks are working closely on this. It's the law; we need to comply with it. This is incredibly complex, and there are different ways that this could be accomplished. The regulations on how it's to be accomplished yet haven't been published, not even – we've got the law; we don't have the – how do you want us to do this? How do you draw the boundaries? But the cost of this could be very, very, very significant. Now, when you then think of the possible cost impact, and in 18 months conceivably the Competition and Markets Authority coming back and going, 'Right, we would like' – which they may or may not do – come back and say, 'Right, we would like some structural change', and meantime, in those 18 months, the banks have gone down a path on ring-fencing and incurred very significant costs to do so, unless they get those exercises lined up - back to square one.

Chintan Joshi

So the costs that were submitted in the ICB consultation process, the numbers that they gave, are outdated, given scope?

Iain Mackay

I think they are, yeah.

Chintan Joshi

Thank you.

Iain Mackay

There's a question in China, I think. China? Hong Kong, sorry.

Facilitator

We have a question from the line of John Caparusso, from SCB. Please go ahead.

John Caparusso, Standard Chartered Bank (Hong Kong)

Yes, good morning. This is basically on the overall trajectory of the risk posture of the Group as a whole. In the first half – it looked like there were still a number of kind of de-risking measures. I seem to recall that in Canada, for example, you were kind of running off or winding down the consumer finance business, and at the same time, of course, there's the well-known run-off of the CML portfolio, and now kind of a – I guess, on the front book, potential increases in risk on new exposures coming forward. So if you put all these together, is the overall posture of the Group now sort of flexing toward increasing risk overall, such that the kind of drag on the margin for the Group as a whole will now start to abate, maybe over the second half? Should we expect that to start happening? Thanks.

Iain Mackay

So just to answer your comment on Canada, the run-off in Canada is actually – was part of the finance company that was acquired in the US, many, many years ago, and so that run-off is simply the Canadian element of that business, which was actually merged – the management of that business was merged with bank management a couple of years ago, and they've progressively been running it down, so there's nothing new in Canada; it's more an extension of what was being done in the US.

I think I'll go back to some earlier comments around having capacity for risk within the appetite that Stuart and the management team has agreed with the Board, and having capacity within that to take on customer business in the markets in which we operate, and through the global businesses in which we operate, around the world. So I wouldn't per se – I would not say that we're increasing our risk appetite. What I would say is that within the risk appetite we've defined, with which – I think – we and the Board of Directors is happy with the definition of that risk appetite, there is more that we can do, and I think this again goes, perhaps, a little bit more to some of Douglas's comments, amplified by Stuart on the call on Monday, which is making a very clear distinction between financial conduct and compliance risk, versus that of knowing our customers and serving our customers through the balance sheet capacity that we've got, and putting the effort in and taking the extra step to get to know those customers, and drawing conclusions as to whether we can, in actual fact – whether we can, or wish to, serve them as customers, and if we can draw that happy conclusion, then using the capacity that we've got on our balance sheet and within the risk appetite to serve them.

But we're not sort of sitting here going, 'Right, we've been far too risk-off for the last year.' There was a very deliberate process of looking at the shape of the Group strategically, in terms of the markets we operated in, the types of businesses that we did, and trying to simplify this down to a set of core offerings through four global businesses. And that's what informed dispositions over the course of the last three and a half years. At the same time as we formed four global businesses, those businesses continued to work with our customers, and I think if you looked at one of the very first charts – in fact, it was the first chart that Stuart spoke to on Monday morning – when you looked at the revenue growth generated by those businesses over the last four years, they were growing their revenues. It was rather difficult to see the growth in those revenues, because we were selling lots of business and we were de-risking certain product lines within some of those businesses. So the simple answer is, there is capacity to provide further support and services to customers that we operate with around the world, but we're trying very hard to ensure that everybody in the Group doesn't confuse our appetite for risk in that area with the fact that we've got to ensure that we've got a consistent implementation of our global standards around the Group.

John Caparusso

That's helpful. I guess what I'm trying to get at is, if you can hold constant the shape of the yield curve in the interest-rate environment, should we now expect – just purely based on the risk posture of the Group – that the margins would now have stabilised, or, you know, might start to increase, purely as a function of the amount of risk on the balance sheet?

Iain Mackay

I think it's fair to say that the margins have stabilised. There's certainly evidence of the latter part of last year and the first half of this year – is that margins in the round for the Group have stabilised. There are areas where we've actually seen some margin expansion: for example, asset spreads in UK Commercial Banking have improved somewhat, and the spreads on global trade receivable business in Asia, for example, have very much stabilised. While we sit sort of around the zero band from an interest rate perspective, particularly those currencies which have the greatest impact on the performance of the Group, until we move out of that – real recovery in margins, although we will pursue those opportunistically as we have done in markets such as the UK where the opportunity's been there, in terms of a broad-based rebound, I don't think, until we see some movement in interest rates, that's necessarily realistic.

John Caparusso

True. Okay, many thanks.

Iain Mackay

So one last question. Down at the end of the table – sorry, can't see who it is. Chris, yeah.

Christopher Manners, Morgan Stanley & Co

Good morning, everyone. It's Chris Manners from Morgan Stanley. Just two questions, if I may: the first one was when I look at the sort of split of revenues by different business line, the other income in the quarter did seem to be quite strong at 1.5 billion on a clean basis – so, up 30% year-on-year. Just trying to maybe get a sense of if that's the sort of sustainable run rate we should be looking at now. And the second question was maybe just a little bit on capital? I saw that standards, the Pillar 2A requirement, went up by 25 basis points for them. Are you, sort of, happy that your Pillar 2A requirements are stable, or do you think the PRA might sort of push it up a little bit? And then, also, some thoughts on the leverage ratio consultation? I know for HSBC, given your risk weight density, it's actually less of a concern, but just where you see that ending up, and how much you think about leverage when you manage the business?

Iain Mackay

Okay, so come back to me on your first part of that question, on other income?

Christopher Manners

So when I look at the split of the revenues for the Group on a business line basis, the sort of 'other' line – so not RBWM, CMB, GBM or GPB; the 'other' – seems to be quite strong at 1.5 billion, once you've stripped out the exceptional revenues of minus 290 million. For the quarter, that is. It's one that came from the sort of quarterly breakdown you give in that spreadsheet.

Iain Mackay

There's a couple of things coming through the other income line. There were a couple of tax cases in the US where the provisions that had been made were more than sufficient to the agreements that were reached with the IRS, and that's one of the aspects impacting it. Another aspect was just some of the revaluation movements on hedge effectiveness which come through the other income line, and obviously there's a little bit of volatility related to that, based on the move on the underlying basis. Now, most of that is interest-rate risk – well, it is basically interest-rate risk that is being managed in that respect, so it's somewhat dependent on movements on the yield curve. As we scurry through the papers here, there's no single item that sort of jumps out in that respect.

Christopher Manners

Okay, thanks.

Iain Mackay

On Pillar 2A, I'll sort of go back to Jane's comments here. Our expectation is that Pillar 2A PRA buffers will be informed by stress-testing, and certainly there is no discussion, I think, that we've had with the PRA in the last six months which has informed whether Pillar 2A is likely to change; whether it is likely to be substituted by the PRA buffer; how that might interact. Our position continues to be that we are well-capitalised at 11.3%, common equity tier one. I think, in fairness, when Stuart and I meet with Andrew Bailey, he also says we're well-capitalised; he just happens to add one word on at the end of that, which is 'now', which is not particularly helpful, but he recognises that we're well-capitalised and that as a Group, we generate a lot of capital.

I don't think – you know, it remains some time until we get clarity around sectoral capital requirements, and our expectation – our hope – is that the stress-testing will inform how the FPC intends to move forward with the implementation, if in fact at all, with some of those requirements. From our standpoint, we're generating – as is evidenced by the data, we're generating capital from operations; we're retaining part of that within the retained earnings portion of the balance sheet to support future regulatory requirements, such that they may arise; and what is equally clear is that we have the capacity to support progressive dividend – and that's how the Group is being managed, such that we can meet capital requirements and meet progressive dividend requirements. Oh, yeah, the leverage ratio – one of the best consultation papers we've ever seen – absolutely outstanding piece of work. Now, you'll see our response to the consultation when we send it in.

Russell Picot

Thankfully, that was the last question it seems.

Iain Mackay

Yeah, that was the last question. Anyway, thanks very much, everybody, for your time – as ever – and for your interest. Thank you.