HSBC Holdings plc 2012 Investor Day – strategy update
Introduction

Edited transcript
17 May 2012

Douglas Flint, Group Chairman

Ladies and gentlemen, welcome to our update on the strategy that we laid out almost exactly one year ago today. First, can I draw your attention to the statement on forward-looking information, but I think you're all very familiar with this by now. My role today is simply to set the scene and provide a context from the perspective of the Board on how we set and judge the performance of the Executive team, which Stuart leads.

In summary, let me say from the outset that the Board is very satisfied with progress made to date on delivering the strategy that it endorsed one year ago, and that satisfaction was reflected in the scorecards that we published in the remuneration report in last year's annual report and accounts. The judgments that were made on performance were possible because there was a clear framework for evaluating progress and delivering the strategy, and that informed the Board's calibration of outcome against its own expectations. It's also very reassuring that the benefits foreseen in the underlying strategy of moving capital towards organic growth opportunities in priority markets have been reinforced by the delivery to date.

As you are well aware, we set our strategy against an evolving and uncertain landscape in terms of the capitalisation, the shape and, therefore, the future profitability of our industry. So, against this backdrop, what were the priorities put forward by management and endorsed by the Board to prepare HSBC for this uncertain world?

- First, put the right team in place, and this is now complete and functioning very well.
- Second, simplify the structure of the Group by eliminating non-core or subscale businesses. 28 transactions have been announced since the beginning of last year.
- Third, address cost efficiency through organisational design and de-layering.
- Fourth, strengthen our capital position through retention and set out a pro forma model as to how post-tax profits should be allocated. As you have seen, that was calibrated during last year as 50% to retention, 35% to dividends, and 15% to performance-related pay.
- Fifth, add to liquidity and preserve a balance sheet funding structure which is underpinned by core deposits.
- Sixth, position the Group to take advantage of a noticeable retreat by peer banks to their home bases, promoting trade finance which aligns well with governments' export priorities.
- Seventh, concentrate our incremental capital allocation to the faster growing markets, which are both our heritage and our future.
- And eighth and probably most importantly, stick with HSBC's historic strengths and risk appetite.

Our progress to date has been strong in many areas, in particular in reshaping and simplifying the Group. The Board recognises we remain on a journey, encouragingly on track at this juncture to reach our financial targets. Recognising that expectations are changing in a more integrated and sophisticated world, the Board exercises particularly strong oversight on the definition and application of Group standards to preserve and enhance our reputation. HSBC aspires to lead our industry in implementing the most robust global standards and controls, and this means in practice adopting the highest regulatory and compliance standards applying to any part of the Bank in every part of the Bank. This costs money, but falling short costs much more in terms of reputation, on top of inevitable fines and compensation payments. This is, in today's world, a never-ending job requiring intelligence, stamina and imagination. Good intentions will never be enough as illicit actors today are technically aware, well-resourced and tireless.

I won't go through this slide in detail – you're all aware of how the economic, regulatory and political landscapes have changed since we articulated our strategic objectives a year ago. None of these impacts our strategic direction or our ambition, but they will impact tactical decisions along the way, which is a very good point at which to hand over to Stuart and his team to address these points, take you through the strategy update in detail, and remind you of the distinctive strengths and capabilities of HSBC that underpin that strategy. Thank you. Stuart?

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Group Strategy

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Stuart Gulliver, Group Chief Executive

Thanks, Douglas. We're going to take a slightly different approach this year to last, in the sense that we won't give you nine and a half hours of presentations on HSBC. We'll try and end this by lunchtime. So, today, you'll get a presentation from myself, from Sean and from Iain, but, actually, all of the key people running the key global businesses and geographies are in the front two rows, so, when we get to the Q&A session, we'll involve everyone. And also, therefore, you'll get the chance to meet up with the top management team during the coffee break and over lunch. The idea also is that we'll go through the presentations and take all the questions in a bloc at the end, so I want to, basically, be able to flow through the presentations.

So, essentially, I'm going to go through three chunks. First of all, the report card. We set out a report card last year that said what we were going to do with the firm, and so I'm going to talk in some detail about what we have actually achieved during the course of the year, to give you an update on the report card. We'll also then set out what our end-state vision for HSBC actually is. And then, thirdly, we'll talk about what the priorities are for this year and, effectively, set a new report card.

So, if I go back to where we were last year, you will recall that we made the point, which you will have all noticed, that HSBC was, basically, regarded as a default defensive stock. So, it went up less than others in the good times but it went down less than others in the bad times, and people owned us more because we were defensive than because they actually endorsed any business model that we had. So, what we set out to do was to make an investor case to yourselves, which, essentially, looked at HSBC's rather unique competitive advantages and then set out a journey for us to be able to capture and take advantage of those competitive advantages, which really comes from the observation that the centre of the world's economic growth, actually, we think, has already moved from west to east and north to south, and that we will capture those opportunities through our network, which will then be driven into and trade and capital flows captured through Global Banking and Markets and Commercial Banking, and through the enormous wealth creation that's taken part in those emerging markets through the Retail Banking and Wealth Management proposition.

But we also acknowledged that we face substantial challenges because a lot of our businesses were delivering a return on equity below our cost of equity, our costs had moved up to US$41 billion – it had grown $4 billion in the previous three years, without any revenue being generated – and, obviously, the regulatory environment was also continuing to require us to hold more and more capital. So, we basically set out to illustrate how we were going to manage the firm a little bit better and we set out a report card, where we said that we would, in future, look at all of our capital deployment using the five filters, which, if you will recall, the first two filters are:

- Is the economy really going to be of any size and scale in the future?
- Does it connect to the other countries in which we operate? And that connectivity is incredibly important; it explains the geographic footprint of the firm.
- If a country gets through those first two, is its return on equity above our cost of equity?
- Is its cost efficiency ratio within or trending towards that range of 48-52%?
- Does it provide funding to the Group?

So, if we look at, first of all, capital deployment and the May '11 report card metrics, which are on the left-hand side of this slide, we have completed 28 disposals during the course of the year, and these have released about $55 billion in risk-weighted assets and we'll try and throw around 15,000 headcount to the new acquiring institutions.

We've also made good progress on working towards our $2.5-3.5 billion of sustainable cost saves by 2013 by simplifying and de-layering the firm. So, we have already got $2 billion of sustainable saves identified. They're not audited by KPMG, but, when we say sustainable saves, it's not that we've made it up; they are verifiable sustainable saves and we've got $2 billion of those already flowing through.

And that also represents itself or manifests itself, to some extent, in 14,000 – and this is in addition to the

15,000 figure above – people leaving the firm through effectiveness changes – and I'll talk about that in a bit more detail.

Then, very importantly, we've actually started to demonstrate how we've managed to invest in the fast-growing businesses. We've seen substantial growth year on year in revenue in Latin America, in Hong Kong and in Asia-Pacific, so we've been able to deal with the wage-price inflation which worried all of us and, actually, generate quite significant positive jaws in those fast-growing emerging markets. At the same time, we've captured about a $300 million, 6% increase in wealth revenues, during a period where the market's mostly been risk-off and, actually, during a period where we've been building the platform to push out the Wealth Management initiative and, so far, about $500 million in incremental revenue through Commercial Banking and Global Banking and Markets working much more closely together. That's already been booked and we actually will talk later on about increasing the target for that particular activity.

So, now what I'll do is go in some detail into each and every one of these. This sets out the track record of disposals of HSBC over a long period of time. You can see, actually, in 2011 and 2012, we've had an unprecedented number of disposals and closures, and we've also significantly reduced the intensity of acquisitions. We've averaged, actually, about 10 transactions per year since 2000 in terms of acquisitions. It's not on this slide, but we've done 106 acquisitions from 2000 to 2010; 46.3 billion in consideration.

We will, obviously, be applying the five filters going forward, so you can expect to see a significant reduction in the number of acquisition transactions that we do, because there'll be very, very few that hit the five filters. What you can see is a significant period of disposals that have taken place. So, we have put the five filters into play and, actually, I think that where we have probably outperformed, certainly, the expectations of some of the media is in the speed with which we've got on with these disposals. You probably will recall, the day after the 9.5 hours, Lombard in the *FT* said, 'Well, that was all very interesting but they'll never achieve anything because of the treacly inertia of HSBC.' We'd like to think that we've given some proof to you that getting rid of 28 businesses in the course of a year, as well as identifying $2 billion of sustainable cost saves, as well as effectively managing 30,000 people out of the firm – 15 through disposals, 14 organically – should give you some confidence that our management team actually has the ability to get its arms around HSBC and to push forward change.

the changes that we're making – the organisational But the important point I want to make about acquisitions is we, effectively, have done three: we've invested in BoCom and topped up our shareholding in BoCom, so we weren't diluted; we've merged our operation in Oman with Oman International Bank; and we've bought Lloyds Bank's operation in the UAE. The important point about the acquisitions and the use of the five filters here – and I'll say this several times – is, if we're very disciplined, it means that, as and when we get to whatever the Basel III recovery and resolution, ICB final capital point is, we will be not doing a series of random acquisitions, which is what we've tended to do in the past; we'll clearly be returning the money to our shareholders. Because, if we apply this discipline, once we've hit that threshold and we are capital-generative, what's gone on in the past is we've done about 10 acquisitions every year and, as I say, they've totalled up to, actually, about $46.3 billion over the period 2000-2010. We won't be doing this going forward, which should give you line of sight and comfort to the fact that, once we've hit all the regulatory capital requirements, which both Iain and I will talk about later, we will start to shift the way we look at the dividend payout ratio.

Also what we've done, clearly, with these disposals, is two things, and there's two very different things going on within the disposals and it's important to bring these out. So, the US repositioning was, effectively, to shift the business in the US. The US is an incredibly important country to us – it's the biggest source of investible funds in the world; it is the biggest economy; it will remain in the top two for the foreseeable future – but we've had the wrong business. We bought Household, which was, obviously, with the benefit of hindsight, a mistake. So, the disposal of the card business, which, actually, has a higher ROE than the Group average and a better cost efficiency ratio and is dilutive by its disposal, is because it's just not strategic. We said this last year but, just to rehearse it again – and this deal closed on 1 May – the type of cards that sat within the Household portfolio basically were used by people to finance their credit requirements between weekly wage receipts, so they were used to literally buy gas and buy pints of milk and so on. And the credit performance of the portfolio was very good because this was the line of credit that the subprime borrower had to preserve. Yes, they could walk away from their property, because it was non-recourse, but you absolutely needed to keep your credit card going because you needed it to basically manage your day-to-day financing. Clearly, there's no cross-sell possibility whatsoever from such a portfolio; there's no connectivity from such a portfolio, so it's non-strategic. So, it's painful in the short term because it's dilutive, but it's the right thing to have done. It has released a $40 billion or thereabouts risk-weighted asset and it has released a chunk of capital that sits in the United States at this moment in time.

What the other disposals mostly are about are about simplifying HSBC and about dealing with fragmentation, because one of the reasons we've had a conglomerate discount is we've tried to be all things to all people everywhere, and this has two or three problems to it: one is it gets a very poor valuation, because it's very hard to explain to people like yourselves as to why we're doing historically car insurance in Argentina, lending to people with very low FICO scores in the United States, while doing private banking in Hong Kong and being ranked number four in the debt capital markets globally. People will say, 'What's the synergy of that? What's the operational efficiency?' and, clearly, there was none. So, it's important that we clean out and create a cohesive set of four global businesses and a cohesive set of geographies, because that, actually, should help people see what the underlying advantages of HSBC are and we should be able to get a better valuation.

The second reason for doing it, though, is to improve the control environment. There's obviously – and again this surfaced again last week with the unfortunate events at JPMorgan – a sense that banks like this are too big to manage. One of the ways we make HSBC easier to manage is to simplify it. Actually, if you have four businesses and a cohesive set of geographies that are doing the same types of things, you can clearly scale. If you are doing hundreds of different heterogeneous operations in multiple countries, you can't scale, actually, because that's where the complexity of management and controlling such an organisation comes from. So, part of this fragmentation issue is about acknowledging the fact that large institutions like ourselves have to become much more logical and cohesive, with simple, identifiably common activities that are done across multiple geographies as opposed to multiple different activities done across multiple geographies. So, a number of the disposals – and they're listed here – are about dealing with fragmentation.

Then also, if we dig into, for example, the insurance piece, we've recognised that, actually, we're not the best owner of general insurance assets. It is better for us to have, in essence, sold our general insurance businesses, which we have done, to AXA and QBE, and to actually then get into bancassurance deals with those particular institutions to sell general insurance, than to run our own general insurance portfolio. This is, again, part of the five filters process: are we the best owner of a general insurance business? I don't think we got any valuation in our share price at any point in time for actually having a general insurance capability. We, however, are now able to deliver general insurance products to our client base through those bancassurance deals with leading insurance companies like AXA and QBE. In the Middle East, actually, we've also done a life assurance bancassurance agreement with Zurich Re to distribute there.

Elsewhere in our business, we continue to manufacture life in a number of countries but, where we aren't manufacturing, there will be a future transaction that we'll talk about, where we will announce a bancassurance arrangement to distribute life insurance in those areas where we don't currently manufacture.

And then the geographic fragmentation needs to be also explained. One of the things we've noticed is a couple of our competitors suggesting that one of their big advantages is their enormous geographic footprint and, of course, we've closed a number of things. So, let me explain what we're doing here. What we've done is we've closed mostly retail banking operations in countries where we have no right to win whatsoever, because mass retail banking requires significant market share. So, we're only really a mass retail bank in the UK and Hong Kong. In our growth markets, we're going to focus on the mass affluent segment, which is basically Premier.

In most of the countries where we're exiting here, we have tried to be a retail bank and clearly have had one or two branches; for example, in Thailand, we had one branch from 1865 to a couple of years ago and then doubled it to two. It's quite hard to be a retail bank with two branches. Unless people live near those branches; it's a bit troublesome. So, what we're doing, though, in Thailand is we remain in Commercial Banking and we remain in Global Banking and Markets, so these are not complete withdrawals from countries; this is accepting the fact that you don't actually need a retail banking business in order to be able to do Commercial Banking and Global Banking and Markets and, actually, if you're trying to do retail banking in Japan, you're not going to win against the Japanese banks. We've had a crack at it since 1865, so I think it's reasonable to assume that you don't have a competitive edge.

So, if you sell these, there are better owners of these businesses, there's a release of capital risk-weighted assets, and there's an improvement in the control environment that comes about from doing it. But, as I say, don't misinterpret these as a series of full-country exits. We're not exiting Japan, Korea or Thailand; what we're doing is looking to exit the unprofitable Retail

Banking and Wealth Management business so that we can focus on those Retail Banking and Wealth Management countries where we have scale and can be profitable, and focus the rest of the operation on those global businesses where, again, we will have a profitable business.

It also would be true to say that, if you analysed – and a number of you have done this – the PBT, for example, of Retail Banking and Wealth Management, and put the Consumer Finance business of Household to one side, you'll notice that the P&L is incredibly concentrated. So, if you take the top 22 countries, they account for about 90% of the profit before tax of the business. So, you've then got this very long tail of small Retail Banking operations with significant, therefore, compliance challenges, and they're actually just not paying the freight. So, there's also a logic from a control environment for wanting to do this kind of thing.

That has, again, informed some of the stuff in Latin America, although, in certain of the countries, we've actually made a full exit simply because they failed the five filters. So, if you do the five filters on Japan, it's quite clearly a rather important economy, so, therefore, you're going to keep your Global Banking and Markets and Commercial Banking business. If you do the five filters on Costa Rica, El Salvador, Honduras or Paraguay, they clearly don't hit the five filters. These are not going to be economies that are in the top 50 of the world; they don't have massive connectivity to the other operations or the other countries in which we operate. So, that's why there are full exits there.

And you will also have seen, again, that we have, even in countries such as Argentina and Mexico, disposed of some of the insurance assets that we have in those places, where, again, I don't think we were the best owner of those insurance assets. So, again, a major programme has gone through over the course of the year to reduce fragmentation in Latin America, as well as, as I showed on the previous slide, in Europe and in Asia.

So, the other thing, obviously, that we talked about doing was to get our cost base down, and I think it's important as well to look at this. So, the overall descriptor of this is organisational efficiency, and we have not been the leanest and least bureaucratic organisation around. Our cost base grew substantially, actually, without any revenues being attached to it, up until 2011. The way we're doing this is through four programmes, and I'll touch a little bit on them and then Sean is going to do a very detailed presentation on this, because this is clearly how we hope to get you comfortable with how we can get the 2.5-3.5 billion of sustainable cost saves through.

A large part of this comes about from redesigning HSBC. From the outside, you would have thought that a firm of our size and scale – 300,000 full-time-equivalent staff as at the end of the first quarter of 2011, and operating in 80-plus countries – would have huge operational efficiency; the economies of scale would be fantastic. Actually, because we ran the firm as 80 different banks, we didn't get any economies of scale; actually, quite the opposite – we had diseconomies of scale. So, implementing consistent global business models and appointing Paul as the single Head of Retail Banking and Wealth Management, and Alan as the single Head of Commercial Banking, means, for the first time, that we will be able to get a consistent operating model into all the countries.

That has phenomenal implications for everything: it has phenomenal implications for the IT costs of the firm, because you don't have proliferation; it has phenomenal implications for just the operating costs. I forget how many it is, but we have 85/86 facilities management companies who manage our buildings around the world, whereas you would have kind of thought that we would have one or two and drive a massive cost saving through that by forcing the economy of scale through. Because we ran with this 'country head is king' model, which dates from the late last century – actually, the century before – we've not managed to do that. So, this organisational change is incredibly important. It's hard to stress how important this is, and it's possibly almost impossible to see it from outside, but it's incredibly important, because the only way you can get the economies of scale you'd have thought that a firm of our size and shape should have is to, basically, implement consistent business models.

To start, then, that then enables us to streamline IT, and that then enables us to, basically, reengineer our global functions and our operational processes. So, again, just as a practical example of this, we have 12,000 people doing collections at the moment in multiple locations. You can see how, if you move to having three collections centres – one for each time zone – you probably don't need 12,000 people doing it, and you actually can start to drive some operational efficiency through your systems, through your property cost, etc., as well as the people. So, Sean will go through this in considerable detail, but we have already identified $2 billion of sustainable savings, so we're confident we can get to the upper end of the 2.5-3.5 billion target that we set.

This is just a reminder of the growth opportunity that exists for HSBC. This is, actually, a macro slide – it's not specific to us – but it does point out, in very, very clear terms, that the opportunity in the countries in which we've been in place for a long, long time is vast. By 2050, our economic research team believe that 19 of the 30 top economies in the world will come from the faster growing markets. That's where the wealth creation will be; that's, therefore, where the wallet increase for banking services and products will come from. These markets are mostly still under-banked: only 35% of adults in India use a current account, 64% in China, 56% in Brazil, 27% in Mexico and 58% in Turkey. So, in Retail Banking and Wealth Management, the opportunity of that demographic shift as wealth is created and as a middle class is created is absolutely significant.

It's also significant as trade flows not just between these countries and the developed world, but south-south trade starts to jump as well between emerging markets and emerging markets. That trade piece is a huge competitive advantage to HSBC. To have our geographic footprint and to have the heritage we have in trade, which literally does date from 1865, gives the firm a massive competitive edge. As I say, these significant demographic and significant macro circumstances present a huge opportunity in terms of growth of banking services. The wallet for banking services, whether it's Commercial Banking, Global Banking and Markets or Retail Banking, will sit in these countries, and these are the countries which we've been in for a very long time.

Actually, we have shown growth. Although, in the annual report and accounts and when we've reported, to cut through the FX movements and repos and reverse repos and so on to dig into what's actually happening in terms of customer advances is often complicated, if we focus here on gross loans and advances to customers in those countries which have got more than $10 billion of risk-weighted assets, which is on the left, and the growth in regional PBT, which is on the right, you can see, in the '10 versus '11, there's substantial growth coming through in our underlying advances, which is clearly what will drive our net interest margin and will drive our non-funds income.

So, in Asia, we have also – and I'll come back to this – substantially increased and enhanced the capability of our Global Banking and Markets business; our ECM league table position in Hong Kong, for the first time ever, came in at number two. We've massively invested in making sure that the ECM and Investment Banking proposition is as good as the foreign exchange and debt. In Latin America, in Retail Banking and Wealth Management and CMB, we added 800 RMs last year. We've also, in the Middle East, seen a substantial increase in cross-border income within the Middle East countries, as we run it much more cohesively as a single set of businesses.

The Wealth arena: it's worth just focusing on this, because this, I'm sure, will be one of the questions that will come. So, we set a target of US$4 billion for incremental growth. Now, we precisely did not set a date at which we'd do that US$4 billion; we said it was a medium-term aspiration. In 2011, we saw a 300 million increase. Now, on one level, you may say, 'That's very, very modest,' but what I would point out is this. That's a 6% increase in Wealth Management revenues in a year in which the market is risk-off, so it's not exactly the most conducive environment to building out a wealth business in Europe, for example, or, indeed, in large parts of Asia that are generally global investors. It also would be true to say that, during this period, we've also had to do a lot of work to build platforms, so there's a tonne of, essentially, initiatives that will get rolled out and deployed in the second half of 2012. So, I think 6% growth in a difficult market, with customers in a risk-off mind-set, is not too bad, and, actually, we're confident that we will still get this $4 billion additional revenue coming through in the medium term from this opportunity.

One of the things that Paul and his team have done during the course of the year is all of the insurance deals that we talked about, to actually improve our pensions and insurance capability, which is clearly key to this particular sector. Also, we've redefined and re-designated and cleaned up the Premier account base. So, we have 4.4 million Premier accounts now, which are genuinely Premier accounts. You will recall that we had, at one point prior to 2011, set a target for customer acquisition, which resulted, I think, in a lot of clients being onboarded as Premier who were far from the mass affluent definition that, actually, is important. Because, clearly, the profitability of this, the Premier accounts account for about 29% of the RBWM global revenues, so that client base, which is about 4.4 million clients, out of a total RBWM client base after the sale of the card business – and the card business, obviously, had millions of customers – the total customer base of about 50 million, within which 4.4 million, which is Premier, account for a third of the revenue, so it clearly is the case and makes the case for why Premier is, actually, a very important initiative for us.

Turning next to the last growth piece, we have already captured US$500 million of incremental revenues by getting Global Banking and Markets and CMB to work seamlessly together, and that revenue has come from a number of different product areas, which are set out in the pie chart. The pie chart shows you where the 500 million has come from. So, it's not simply foreign exchange, it's not simply debt capital markets; it's across a range of products within Global Markets.

Global Banking and Markets has 4,000 clients. Commercial Banking has about 3.6 million, of which 3.4 million are business banking, so 200,000 are what you'd think of as the German Mittelstand, and these are, obviously, the people that are capable of using these types of products. If you've got such a large client base, the big opportunity for the firm lies within it. One of the things that we're constantly – and it's the same point about acquisitions – we're very good at running HSBC. Commercial Banking has been built up over a number of years, led by Sandy, who's with us today, to being a terrific profit contributor – US$7.9 billion of PBT last year. Global Banking and Markets was built, too, from scratch to make US$9-10 billion a year. Neither contains any acquisition. Actually, if we can optimise our own customer base – if you've got 200,000 Commercial customers and 4,000 Global Banking and Markets customers and you actually can harvest that opportunity – it's much better to grow it organically than to go out and buy someone else's business, which, clearly, with our track record, would suggest we're not quite as good at running as our own. So, this is really very, very important: harvesting this opportunity that exists within our own firm is terribly important.

Then, if we come to the first quarter's results, which, obviously, we released last week, and you've all heard our analysts' call and so on, we have made a reasonably good start to the year. The reported profit for the first quarter, which, obviously, includes the loss of 2.6 billion on fair value movements of our own debt, was 4.3 billion, which was slightly down. Obviously, on the underlying numbers, which exclude the fair value of our own debt, the PBT was US$6.8 billion in the first quarter, up 1.4 billion on the first quarter of 2011 and up 3.4 billion on the previous quarter – the trailing quarter – fourth quarter of 2011. This really came about from higher revenues, lower loan impairment charges and flat costs.

So, we do think that reporting on the first year's report card is that we have shown the ability to get traction and show progress on things that are controllable. Things that are within our control, I think that we would hope that we could have demonstrated that we actually have been able to influence and have been able to get some progress on.

So, that then brings me to the second section of my presentation, which is to try and set out what on earth is the end-state vision of the firm. And bear with me while I run through this. We have done a chunk of work on purpose and values. Banks are at a stage now in most of western society where the economies in which we serve expect us to change, and expect us to change the way we behave and the way we conduct our business. And although I would actually argue – and you'd expect me to do – that HSBC has, as always, been very far from the worst of the offenders in this regard, I nevertheless think that, because we're effecting an enormous programme of change – and this is probably one of the biggest root-and-branch redesigns of HSBC that's taken place – it's very, very important for our own staff, actually, internally that we create some sense of what on earth the purpose of the firm is and what its values are and, actually, articulate it quite clearly. So, let me just run through these.

The purpose of the firm is, if you think about it, what on earth do banks do? They help businesses to thrive and economies to prosper. They help individuals to fulfil their hopes and dreams and realise their ambitions. We lend people money to buy their house, to go on holiday, to start a business, to employ people; to governments to build roads, to build railways, to build bridges. So, the reason why we exist is quite logical, and it's quite important, and this has, actually, resonated quite powerfully internally within HBSC. And I think it's actually important. As I say, we're at quite an important moment, I think, in history in terms of the world's appreciation or attitude towards the financial services industry. So, this is in no way, I must stress, a cynical approach to this: this is an important piece of work that we spent, actually, about six months working on. We ran a whole series of workshops throughout the globe with colleagues. There were actually about 5,000 colleagues involved in, effectively, thinking through and sharing what on earth the purpose of HSBC is. This is a very proud firm that's been around since 1865 and it has a rich culture and a rich heritage, and it's important, I think, that we get some precision around what our purpose is.

We also last year launched a piece of work on values, and this is incredibly important. We clearly have failed in some degree in this regard in the past. We have to acknowledge that. NHFA, which you'll be aware of, which is this disgraceful business that sold 10-year fixed income products to old people in care homes, clearly is absolutely unacceptable. We have a series of issues in the United States, which are very, very serious, and we have to, therefore, accept that we need to make it absolutely critical that values lie at the heart of the behaviour of our Executives. So, for the top 300 people, we now evaluate them on values, as set out here, both in terms of their corporate behaviour but also their personal behaviour, and it's a gating system before they actually get to their business scorecard, because I think this is incredibly important. It's incredibly important that our leaders – the top 300 people in the firm – actually do act with courageous integrity and, as I say, it's quite clear that, in the past, we haven't from time to time, so we need to actually deal with that.

Then the strategy we've set out, and I won't repeat it here but it's obviously about the network and CMB and Global Banking and Markets and the wealth opportunity, and the outcome we would expect or hope or aspire is to be seen as the world's leading international bank. Of course, what that should do – and this is to reiterate what Douglas said – is result in consistent returns, where the appropriate balance – and we won't want to hard-code this as defined numbers – should clearly be we retain more money to reinvest in the business and act as a buffer to protect the taxpayer than we pay to our shareholders, which should be more than we pay to our staff. Actually, we've managed to do this for many, many years. We retain 50% of earnings – this is all on a post-tax basis; we pay about 35% to shareholders as dividends and about 15% in variable pay. We believe the first three things will result in the fourth and will drive our desired outcome. I think that, by doing this, it reinforces and strengthens the culture of HSBC, which, actually, we think is one of our big competitive advantages, an extremely important defined competitive advantage, which, actually, we've had for many, many years of our history. But I think it's important here to articulate and set out there's quite a lot of thought gone into this during the course of our first year as a team.

And again, you'll have seen this before, but again it's important to do this: the big business that drives HSBC's competitive advantage, the heritage business, is Commercial Banking. The trade finance platform, the lending to MMEs and SMEs, which, of course, even in this country, represent 60% of the employment in the country, is absolutely at the heart of what we do. So, during the course of the year, we've designated Retail Banking and Wealth Management and Commercial Banking as global businesses, so they then have the same status, along with the Private Bank and Global Banking and Markets, and it's an incredibly important change because, as I said before, that was not the case. It was not the case that there was a single person. We were moving towards it in Commercial Banking. We had not done anything, really, to create Retail Banking and Wealth Management as a cohesive, single, global business, with the result that we had this incredible complexity of systems and variety of systems running through the firm.

We've also clearly articulated the strategy for each of the four global businesses, and these businesses have started to show considerable growth, and you can see where some of the opportunities are. One of the reasons that we've added another billion to the opportunity internally is because we think that the main source of customers to the Private Bank should be Commercial Banking. If you're banking a bunch of people who own their own businesses, who actually are entrepreneurs, who are founders, that's your Private Banking client base. Actually, that's also your Private Banking client base because, in effect, you've KYC'd them, because you've been banking them for years. Of course, that is what the Private Bank in Asia looks and feels like, but the one we bought from Republic National Bank of New York doesn't look and feel like that, and that's clearly what Krishna will be working on changing. But the extent to which we have this Commercial Banking business, I think, is really important.

So, I would expect that, generally, through the cycle we would make 30-40% of our PBT from Commercial Banking, 30-40% from Global Banking and Markets, 20-30% from Retail Banking and Wealth Management, and probably about 5-10% from Private Banking. I realise that the top end adds up to more than 100, but I'm giving you some ranges here. What I'm trying to directionally also indicate is I have no desire to shift Global Banking and Markets, the way Standard Chartered and BarCap have, to be 80-90% of the PBT of the firm. I think it's really important that Commercial Banking, Global Banking and Markets, Retail Banking and Wealth Management and Private Banking are all contributors to HSBC, because that's the diversification by business as well as the diversification by geography that gives us our financial strength.

So, if we now turn on to the geography – this is the first time that we've actually spelt this out – this is how we think about our countries. There are two home markets: the UK and Hong Kong. They account, actually, for 43% of the profit before tax of the Group, those two places, the UK and Hong Kong. We have 20 priority growth markets and, if you take those, together with the two home markets, you've then got 92% of the Group's PBT. Clearly, therefore, those are the 22 countries that we're going to focus our investment heavily on.

The network markets, which is the next category, are important because they are the ones that enable us to service the subsidiaries of the companies who are headquartered in the previous 22. So, if you want to do trade, you clearly need to be in the countries that your SMEs are trading with; if you want to do payments and cash management for a Unilever, you need to be in the majority of the countries in which Unilever's subsidiaries are operating. So, the network markets are important but they're clearly the ones where we will decide whether we need to be in Retail Banking in them, and the likelihood is no – that we need to be in Commercial Banking for trade and we need to be in Global Banking and Markets for PCM and for securities services, for example.

Then there are a number of small markets where we have disproportionate scale and where we have very high returns, which, frankly, don't fit into any logical analysis but, actually, are accretive. So, that would be Malta, that would be Brunei – those types of operations. So, these are very clearly the priority growth markets.

I think it's also important to rehearse – and we'll go into detail and I'm sure we'll spend a lot of question time on this – that we are sticking to delivering the financial targets. As difficult as the cost efficiency ratio may be to achieve, given that, within days of us finishing the investor day last week, the eurozone collapsed – there's a certain repeating cycle to this, so maybe we shouldn't have another investor day and then the eurozone will be okay in future – the fact of the matter is we've got to stick to this 48-52% for these bigger reasons or longer-term reasons, as it were, which are these: we're shifting the focus of the majority of the PBT of the firm in risk-weighted assets to the emerging markets. Emerging market businesses ought to be able to operate with a cost efficiency ratio of 48-52%. So, if we are shifting the firm there, logically we should be able to get to 48-52%.

Secondly, we have $1.2 trillion of deposits. We've kind of forgotten about them because, actually, they've earned us no interest spread since interest rates have been at 50 basis points. If QE leads to inflation, which I expect it will at some point in time, and interest rates move back to 3-4%, US$6-7 billion of net interest margin will come from the deposit base and will come through Commercial Banking and through Retail Banking and Wealth Management. So, therefore, we're not going to give up this 48-52%, albeit that the second one – i.e. the movement in interest rates – is not in our control, and I'm not prepared to take the pressure off internally, which would also result from shifting an external target. Longer-term, structurally, on a secular basis, we should be able to work to a 48-52% cost efficiency ratio at the Group level. It's going to be an emerging market phenomenon and as interest rates normalise, but we'll go into detail on these.

So, let's talk about some of this growth stuff as well in terms of: how can we get to the return on equity that people expect us to deliver? This is a really important slide, because what we're doing is we're, for the first time, showing you there are, effectively, three different parts to the Group. So, we have a run-off portfolio, which, so far, consumes about $180 billion of risk-weighted assets and has a diluted effect of c.0.6 percentage points to the return on risk-weighted assets, so it clearly is massively dilutive. We also have made a series of disposals, so if you look at the disposals and the run-off portfolio, between them there's 234 billion in RWAs. We will continue to run off the run-off portfolios – and I'll talk in some detail about what we're going to do there – and, obviously, we will continue to make some disposals over the course of the coming year.

So, once you take away run-off and disposals, you're left with what we will hereafter call Growth HSBC. Growth HSBC needs some work in Global Banking and Markets, which I'll talk about, and some work in Private Banking, but, actually, Growth HSBC is already delivering a return on risk-weighted assets of 2.2%. So, if you add the home markets from slide 19, which I talked about, the priority, network and small markets, they actually deliver 2.2%, which is our target range. So, that's why we're reasonably confident we can actually hit this ROE target. And remember that, in the first quarter's numbers, the reported ROE was 6.4, but, of course, it included 2.6 billion of fair value of owned debt. Now, you shouldn't annualise the fair value of owned debt number. If we annualise the 2.6 billion, we're trading through gilts at that point in time, which is unlikely. So, therefore, we think it's better to look at the ROE on an underlying basis, excluding fair value of owned debt, because it's not really an annualisable number, and we're at 11 anyway.

Obviously, on the capital ratio, we are at 10.4 on a kind of Basel 2.5 basis, and we're comfortable, obviously, that we're creating capital, and the sale of the cards business will add a chunk of capital to our Tier 1 ratio here in the second quarter, now that it closed on 1 May.

So, going next to the final part of my presentation, it breaks down into three broad areas. So, what are our priorities going forward? Really important again to avoid the conclusion that this is not about growth: these are not in the order of priority; these are just in the order of talking about them and do not reflect any priority being attached to simplify over grow. I haven't mastered speaking simultaneously on three subjects.

So, we are going to have to simplify the firm, and I'll delve into detail on the run-off portfolios, the fragmentation issue that we still need to deal with, and the organisational change that's taken part within the firm, which also clearly helps us control it better and also run it more cheaply. We will also need to restructure the businesses that are not performing, and we'll talk there about the US, Global Banking and Markets and Private Banking. Clearly, there's a bunch of business that we intend to continue to grow, and this is extremely important to focus on the growth bit as well, because, obviously, as we run down these portfolios and dispose them, we have, if you like, a form of self-help, because we will be releasing risk-weighted assets that consume a huge amount of risk-weighted assets and be able to redeploy them into other activities which have lower risk weights. So, if you've got a bunch of stuff that's consuming capital with high risk weights and it runs down, you should be able to actually redeploy the capital, and I'll explain it a bit more in a minute.

So, first of all, the legacy book in the United States. This book, actually, at the end of the first quarter, was down to 45 billion. We have, actually, already had BlackRock do a piece of work for us on the valuation of this book. We will, hopefully by the end of June, probably complete the first small trade of selling a chunk of the book off – modest chunk of the book off – as a kind of test case. We will, therefore, look wherever we possibly can to accelerate the disposal of this book. We have got about $8 billion of capital from the card business that's in the United States. It may well be logical for us – and we will look at this on an NPV basis, what the opportunity cost is – to use some of that capital to accelerate the reduction of this book. It depends, to some extent, on the US property market continuing to improve as to what the gap is between the mark to market of the book and where that eight billion is, and we've also got to be mindful of the deferred tax asset, which is worth US$5 billion in the United States.

But what I would want to communicate to you is we were shocked, I think is the best way to put it, at how fast the share price fell in the third quarter, when the loan impairment charges on this business jumped 900 million. So, this has a disproportionate impact on our share price and, therefore, it might be a lot smarter for us to use some of the capital released to tidy as much of this up as we can, so we are going to look at doing that. The second thing that we'll also look to do as well – and Patrick Burke is with us here, who runs this operation day to day – will be to look at how we can deal with the servicing, because, clearly, at some point in time, we'll have a piece of operational risk around the servicing of this as it runs down. Ultimately we'll have a portfolio probably in 10-15 years' time and we need to deal with the operational risk around it. But the sales of the portfolio, we will start to look at, initially on a reverse-enquiry basis, whether we can start to sell chunks of this book. There are clearly signs of investors starting to look at by specific region – i.e. property in Nevada or property in Florida – particular areas of the United States, so that will be one of the things we look to do.

In Global Banking and Markets, we are simply going to look at the NPV of the holding cost of positions versus the NPV of taking the hit by actually selling them on. So, these are the positions in the SIVs and conduits and, actually, we sold 7 billion in risk-weighted asset terms out of these books in 2011 – disposals and unwinds – and an additional 4.5 billion out of these books in the first quarter. So, this is simply: if the present value of holding the position is greater than the overall loss on sale, we'll continue to hold; if the loss on holding is greater than the loss on sale, then we'll sell it. So, that's very, very simple but that's just to let you understand the framework that's constantly being run, and there are teams of people in place working for Samir, whose job it is to look at this every day. So, we're on an active programme to look at, effectively, selling down these portfolios.

We will, obviously, continue with the five filters and, again, it's worth, perhaps, pointing out here that, as the regulatory environment shifts and, perhaps, we're required to hold ever greater amounts of capital, or, indeed, if the ICB creates a form of ring-fence here in the UK that creates two banks, neither of which gets an ROE above our cost of equity, then the five filters will also have to apply to those operations. At this moment in time, we don't know what the final White Paper says – it'll come out, we think, in June – but, obviously, the five filters apply to everything, always, all the time. We can't have exemptions from that. Clearly, we will try our hardest, because it's in our interest to do so, to create two banks, both of which have ROEs above our cost of equity through time, but we don't know about that at this moment in time. But just to be completely clear, the five filters; we will continue to actively run everything we're doing through the five filters all the time, because I think that tough, hard discipline is absolutely required. If you think about it, so far the transactions announced have resulted in a substantial release of risk-weighted assets and a substantial reduction in headcount that's taken place, and a substantial simplification in the firm. This simplification is incredibly important.

So, this is worth, again, spending a bit of time on. It's a bit of a busy slide but let me just run you through this. So, first, organisation: we have to run this firm by having excellent people who can follow first-class values, and we also have to simplify the firm and remove bureaucracy. So, what have we done? So, first of all, we've defined an 8x8 structure and we continue to roll that out through the Group. So, what this means is there should be a maximum of eight layers within the organisation, from myself as Group CEO to frontline staff, and an increased span of control, eight reports per manager. Now, actually, at the deepest part of the firm, before we did this, there were 17 layers between me and frontline staff, and we also had several instances, particularly in Europe, of people reporting to themselves. They did very well every year on their appraisals – outstanding performers. This is, actually, what drives a lot of the headcount reduction. As you run through this 8x8 model, this, effectively, is the industrial process, because this is done with very heavy documentation, very precise blueprints so as to protect ourselves against people settling scores and favouritism, so it's a very, very mechanistic, industrialised process. This is what informs the 14,000 people who have left the firm. This is also what informs the 3,200 here in the UK; net, it will be about 2,200. Part of it is the 8x8, part of it in the UK is the Retail Distribution Review, which just makes it impossible now to sell retail products to the mass market, and part of it reflects a change in trend in terms of the call centre in Hemel Hempstead, where people simply are now using the internet rather than the phone to actually access most of their information. But a good chunk of 1,000 of those headcounts are a result of that 8x8, and most of the 14,000 are a result of this 8x8.

We also established these four global businesses – really important. Global business, Commercial Banking, shared authority with the geographies – a complete change and it enables us to create a single target operating model which enables us to get massive cost savings on everything: property, software, software development, hardware, phone usage – anything you can think of – travel, because, all of a sudden, we're running it as a cohesive bloc of four global businesses rather than 80 separate banks, which historically is the way we tended to run things.

We've also established 10 global functions, which, again, have equal authority: Finance and Risk have the authority over finance and risk. Again, historically, Risk and Compliance were more in an advisory capacity; they now have the total authority, which, again, is part of dealing with the risk of, 'Is the firm just too big to manage?' What, therefore, at my Group Management Board we have is we have all of the big geographies, all of the global businesses and all of the global functions around a table every month. So, every single person that's required to actually control this firm is present in the Group Management Board, and that was not the case in the past. We'd mostly have the geographies as opposed to the functions or, indeed, any of the global businesses.

What we also will need to do and have started already to move towards is we're going to have to adhere to a single standard globally in terms of our compliance culture that adheres to the highest standard that we must apply anywhere. So, if the highest standard in the world is set by the UK, we'll follow the UK standard, even if we're operating in Hong Kong. If the highest standard in the world is the United States, we'll follow the USA standards everywhere in the world. We no longer, I think, can have again a difference in approach to compliance standards country by country, which, again, is what we historically have seen. We historically, perhaps, regarded ourselves as having an HSBC standard, which, from time to time, was actually, in many instances, higher than the standards of the UK or USA, but in some instances, partly also because we grew by acquisition, was not. So, now we absolutely are saying that we will adhere to the highest standard – oftentimes, it will be the US standards – everywhere that we operate, and this is an important change.

Then on talent, we've put a lot more effort now into very detailed succession plans and expanding the talent pool and creating much more of a demand-led requirement for talent, whereas, previously, we were much more supply-led; i.e. 'There are these people. Let's put them into jobs,' as opposed to what skill set and job is actually required by a bank as we reorganise it and change it. So, the international manager programme, which some of you will be aware of, and a number of us, at various points in our career, have been international managers, we are modernising in the following way. We will still have international managers – they're an incredibly important part of the culture and DNA of the firm – but, historically or in recent years, what's happened is that, because they have pursued a generalist career, they've tended not to have the technical skill sets to rise right to the top of the Bank. Historically, they would have represented everyone at the top of the Bank. So, therefore, we need to get back to a situation where the international managers have a chance to the run the firm, if they have the right talent and ability, and so what we will do in future is we will not recruit international managers directly from university; we will recruit international managers after three years in the firm, having joined through the Global Banking and Markets graduate programme or the Commercial Banking graduate programme or the RBWM graduate programme, so they've got a skill set and an affinity to a global business, and then people can apply for the international manager programme, which will have the mobility. In that way, we open up the opportunity to optimise this: a group of people who are the DNA culture carriers of the firm, but also have the right training and skill set on ability to get right to the top of the firm.

The contrast is best made this way: if you look at the top 28 people of the firm today, there are about two people that are international managers. If you looked at it, say, in ’98, out of the top 27 people of the firm, 27 would have been international managers. The reason it’s changed is the world’s got a lot more complicated, so, therefore, we need to ensure that these people have the chance to get the necessary technical skill sets. So, there’s a lot of work gone on on that as well. As I said before, we’ve introduced a significant values programme and we really are absolutely sincere about this and we’ve managed out a number of people, actually, who have breached values, also at a personal behaviour level. So, the four programmes, obviously, are also part of simplifying HSBC, and we’re pretty confident now that we can get to the 3.5 billion of sustainable cost saves by various actions, which Sean will go into, so I won’t dwell on this too long.

Then, obviously, we’ve got to continue to work on restructuring, and let’s look, first of all, at the Private Bank. The private banking industry is undergoing significant change. The traditional Swiss and offshore, for want of a better word, private banking model that was built on secrecy is disappearing. Private banks face intense competition, additional costs due to regulation and compliance requirements and margin erosion, and, actually, the sources of growth, which are mostly in emerging markets, aren’t easily accessible to many private banks. Now, within HSBC, we also have our particular challenges, because we obviously had a substantial data theft in 2009, which caused us reputational and financial damage. So, we’ve appointed Krishna Patel to run this business going forward, and what we believe that we can do, because we have a unique geographic footprint where significant new wealth will be created, is to reposition this business onto an onshore, disclosed funds basis, optimised into the wealth that’s created in emerging markets, and equally importantly, a business that works really closely with the rest of the Group.

Our Private Bank, historically, was completely standalone; going forward, our Private Bank will source most of its clients from Commercial Banking and will transact the majority of its investment product with Global Banking and Markets, thus enabling us to capture the value chain that’s always existed in HSBC, but organisationally we’ve actually been unable to do.

In the United States, we need to clearly restructure the business. We have had in the United States the wrong business, which has focused on subprime. As we exit the subprime and as we exit the upstate New York branches – Marine Midland wasn’t that great an acquisition either, and that one closes on 18 May; the cards business has already closed – what we want, basically, to have in the United States is a substantial Global Banking and Markets business – which, typically, has made around about US$300-400 million a quarter of PBT and is very focused on Latin America and very focused on cross-border, and we think is now a fit-for-purpose business – and we want to build a Commercial Banking operation which also, hopefully, gets to that kind of $250-300 million a quarter business. It’s currently making about $100-120 million a quarter at the moment. That, we’re confident we can do, for two reasons: one, we have a model sitting just north of the border in Canada, where our Commercial Banking business in our Canadian operation makes about US$1 billion a year. Effectively, it’s a similar client base in the United States that we will focus on. These are SMEs and MMEs that are trading with the rest of the world. Because of our geographic footprint, the only US bank that’s got an equivalent geographic footprint that’s good at trade is Citibank. Most of the other US banks are very domestic in their focus. The US is rebuilding manufacturing because it’s got access to very cheap energy, so there is an opportunity here, and there are about 15 cities within the United States in which we will focus building out our Commercial Banking business. We believe that that, therefore, gets us to a situation where the underlying business in the United States shows reasonable profitability, an ROE of around the 12% level, and actually removes the volatility that has plagued all of us.

Turning now to Global Banking and Markets – and this slide is about the industry, not specifically about HSBC, and this is taken from a McKinsey report – effectively, it’s essentially looking at those parts of the industry that are most challenged post all of the regulation: CRD4, Basel III, Dodd-Frank, etc. – and you can see that structured rates and structured credit become significantly loss-making on an ROE basis post all the regulation going in. The important point from our point of view is this doesn’t have a particularly huge impact on us. We’ve got a Global Banking and Markets business that is different, and I think we’ve put some effort in the last year into explaining to analysts and to investors, with some success, actually, that it is quite a different business.

We think, in the new environment, that three elements will be key for success: you need a deep and diversified client franchise, but it needs to be in those economies that are growing extremely quickly, so you need to be substantially placed in the faster growing economies, where the demographics will also power the wallet size; you need significant access to funding – you need retail funding, you need access to substantial funding, you need strong credit. We have, just in the course of this year so far, raised about six billion in the senior debt markets at very reasonable spreads, and, obviously, we have an AD ratio of 75, so at $1.2 trillion of deposits;

and you clearly need this connectivity. So, we've got a clear strategy for Global Banking and Markets: emerging market-led, finance-focused. Our bond business ranks very, very highly; our foreign exchange business improved its rankings in the Euromoney survey, from sixth to fifth; the bond business is in the top five in the world; and we have selectively built out our equity business in Asia-Pacific, in Latin America and in the Middle East, where we obviously have a client base where it's important for us to capture the value opportunity as Commercial Banking clients list their business, etc. So, there's a logic to why you would do it in those types of markets.

If you look at Global Banking and Markets, and given that the first quarter beat was mostly about Global Banking and Markets revenues, I wanted, basically, to have a slide in this presentation that looked at the minimum, maximum and average range of Global Banking and Markets total operating income ex-balance sheet management, because this should give you some idea, when we deal with the difficult 'What should we do with the fourth quarter? Should we multiply it by four or divide it by a number?' of being able to dig into 'Of our Global Banking and Markets business, how much of these revenues are reasonably reliable?'

So, let's have a look at, for example, the foreign exchange line. You can see that the range and the average suggest that this is a pretty big franchise business. This isn't prop trading by any stretch of the imagination. You can see we have substantial volatility, on the other hand, in credit, which is the eurozone crisis, in essence, and also reasonable volatility in rates. But you can see that some of our products are, actually, pretty stable and have substantial franchise effect. So, therefore, this is not a similar business to some others' Global Banking and Markets businesses. That's the kind of point I want to make here.

So, therefore, we do think that there's a substantial opportunity to continue to grow this business, and, really, only about 14% of the total operating income is challenged by the regulatory changes that are taking place. Actually, Samir and his team are well embarked upon necessary actions to restructure the ongoing businesses, where the regulatory environment makes the cost of capital considerably higher and, as I talked about earlier, there's a whole programme going on to get rid of legacy positions and move those down.

Finally, coming to the last point, growth: as I said at the beginning, this isn't last because it's least important. Maybe it's last because we're saving the best for last, but we obviously have substantial growth opportunities. Better integration between CMB/Global Banking and Markets, CMB and Private Banking, and, actually, even CMB and RBWM, we believe will deliver about another billion dollars of internal revenue that, effectively, we're leaking from the firm because of the way we've organised things in the past. So, that will bring us to two billion, effectively, of revenue. It's just worth reflecting on this. So, if we capture two billion of revenue, and let's assume that a PE is applied of seven to it, that's 14 billion on the market cap. I can't think of a single acquisition that we've done that's added 14 billion to our market cap, so this really is important. It's important to understand that the value for HSBC comes out of us running our own Bank better, actually, going forward.

Then the other thing, I think, to focus on is that, if you look at what's happened to risk-weighted assets, we are, apart from regulatory increases, pushing the risk-weighted assets into the growth priority markets. Remember growth priority markets are the ones that we listed – the 22, or the two home markets and the 20 priority markets. So, growth priority markets is not code here for emerging markets; it's our term for what growth priority markets are. But if you look at what's going on here, we invested 60 billion over the course of 2011 in increased risk-weighted assets in Growth HSBC; 4 billion was reduced by run-off positions; and there was a 50 billion increase net due to regulatory changes of Basel 2.5 going through Global Banking and Markets. So, if you dig into it, we are skewing the risk-weighted assets towards the growth markets – towards those 20 countries. 60 billion risk-weighted asset increase in growth markets, masked by 50 billion increase net in Global Banking and Markets due to regulation. Actually, it's 65 and we mitigated 15 to get to 50, so 60 in Growth HSBC, a reduction of four from run-off, 50 increase in GBM due to Basel 2.5 net, 60 less 15 in mitigation. So, again, to the point of 'What can we control and where we can control things? Have we got traction?' I think this is really important. We really are pushing the RWAs into the priority 22 countries.

We have, actually, been shifting the PBT towards the faster growing regions, so our PBT increased by 14 percentage points to 78% of the Group versus revenue growth of 10 percentage points for half the Group, so it's really shifted, and the loans share has increased by 14%. So, you can see, in these faster growing regions, there is a definite shift and definite proof of concept that we're moving this stuff.

Then, very briefly, the opportunity in Commercial Banking, we think, is absolutely significant. We have a huge advantage in terms of our trade footprint. There was some external work done that suggested we had about a 9% global market share of bank finance trade, which was equivalent to about half a trillion dollars of trade last year, which, actually, kind of verifies with what we think is going through our own numbers. We obviously have a huge advantage as a commercial bank. We have a network that covers, actually, post the disposals, 77% of world trade and 81% of multinational companies. So, if you look at the geography we're left with, it actually explains 77% of world trade and 81% of multinational companies.

We also are already the leading international bank in RMB: we're doing RMB trade settlement in 58 countries around the world. So, this is a huge advantage to us. The other big advantage is, if you look at commercial banking, international revenue growth is running at about twice the rate of domestic growth, based on some work that McKinsey have done. Of course, that's where our big focus is. This is a very hard business for anyone to actually replicate. The entry-level barrier to the commercial banking business is substantially high.

Of course, there's a huge opportunity just by geography in these countries. So, we have, I think, the potential in all five of these to deliver a PBT of over $1 billion. Brazil is already there – it is at 1.2 – but all of these are billion-dollar-PBT countries, potentially. So, in Brazil, we have 850 branches; in Mexico we have over a thousand branches. We have substantial footprints in these countries, so these are all potentially billion-dollar businesses and beyond.

So, therefore, just to rehearse again the priorities going forward: simplify the company, aggressively run-off legacy assets, deal with the fragmentation issue, improve the controls, push through the four programmes to make the firm easier to manage and control, restructure Private Banking and the US Global Banking and Markets, and just force further integration. There's a better opportunity for us to harvest from our own business rather than going out and doing acquisitions. So, therefore, we've suggested here a report card for this year, which we'll review in May 2013, which sets out what we will do by this time next year on the right hand side.

So, I'll now pass on to Sean. I think it is worth just rehearsing the purpose of the firm and just also remind everyone of the very rich heritage that the firm has. That's the coat of arms of HSBC from the boardroom in Hong Kong. So, I'll now pass to Sean. After Sean has spoken, we'll take a coffee break, then Iain will speak, then I'll kind of wrap and then we'll go to questions. That's 'wrap up' as opposed to a musical interlude, or I could try that as well. Thanks.

HSBC Holdings plc 2012 Investor Day – strategy update
Simplifying HSBC

Edited transcript
17 May 2012

Sean O'Sullivan, Group Chief Operating Officer

Thanks, Stuart, and good morning, everyone. So, I will speak to you today about our approach to simplifying HSBC and making the firm easier to manage. In addition, I intend to demonstrate that we have achieved significant momentum with respect to reducing headcount and costs, and that we have a very strong, robust pipeline of actions to deliver on our established targets.

Now, last year, on this similar day, we stated that the overall objectives of the organisational effectiveness initiative were to reduce complexity and operational risk, to become more dynamic and agile, and to support the achievement of positive jaws and improve our cost efficiency ratio from the 2010 base line of 52% to 48-52% going forward.

Now, our vision is to simplify HSBC and make the firm easier to manage, so that our people have more empowerment, more accountability to make faster decisions, enabled by a values-driven culture; that our customers have access to unbeatable propositions and an improved level of customer service; that our shareholders benefit from improved financial performance driven by a long-term sustainable business model; and that we, the firm, HSBC, are more globally managed, more simplified, we're more efficient, effective, and we're a lower risk business that adopts and deploys globally the highest risk management and compliance standards, procedures, policies and systems.

To simplify the firm, we're moving from a series of fragmented businesses to a cohesive portfolio of businesses focused on 22 home and growth priority markets. From a very inconsistent and complex set of management structures that had, on average, 15 layers, average spans of control of 5.8, to much more consistent, simplified management structures that basically implement globally consistent target operating models, that manage by global metrics, and that implement, going forward, always, global, at the highest standard, non-complex compliance operational standards. We're moving from a federated business and functional model to four global businesses, 10 global functions, and one technology and services model.

Now, Stuart talked about the four programmes and, over the past year, over those four programmes, we've made great progress in terms of generating sustainable cost saves as well as simplifying the firm. The FTE reduction from those four programmes has been 12,500. That's up to the end of the first quarter of this year, and then, when you add the 1,500 reductions as a result of disposals closed by the end of the first quarter, that's 14,000 FTE reduction. Now, you can see that that FTE reduction has occurred steadily over the period, as we've implemented those four programmes, and I would note that these numbers exclude a 3,000 reduction in the number of full-time contractors that we employ, primarily in the technology area.

Now, we've delivered sustainable cost savings of $1.2 billion so far across the four programmes. As Stuart has indicated, that, on an annualised basis, drove $1.3 billion in benefits in 2011 and a further $700 million in the first quarter of 2012, so we state confidently that we have generating $2 billion in sustainable cost saves on an annualised basis so far.

Now, we have a number of actions that transcend the four programmes. These are making it easier to manage the firm, it's simplifying the firm, and it's saving us money. Starting with de-layering the organisation – Stuart mentioned this – we're implementing the 8x8 model. This initiative, in itself, will generate $1 billion in annual sustainable cost savings. We'll see the full benefit of that some time in 2013, after we fully roll out the programme in 2012. We're reducing the number of Change the Bank projects across the firm. We've done so by 20% this year. That's allowing us to focus but also save $400 million this year. I would note that we're investing 950 million this year in regulatory programmes; that's up almost 100 million from last year.

We're reducing the number of vendors that deal with HSBC by roughly 10%, from 100,000 to 90,000, and we're also targeting a 5% reduction in terms of sustainable cost savings on the total external spend of HSBC, which is about $14 billion a year. We're going to do that by leveraging the streamlining of the business, the more globalisation of how we operate, but also through improved vendor management. So, for example, we have 1,100 vendors that provide facilities management services to HSBC around the Group, and that costs us 400 million a year. We've recently gone out to the market with a request for proposal, and our objective is to take those 1,100 vendors and it's going to be a handful. From that exercise, we will generate significant sustainable cost savings.

We have targets to reduce the annual cost of running our commercial real estate portfolio, our property portfolio across the world, by 350 million. In the last five quarters, we've released, on a net basis, 280 buildings across the Group. We've also released up to almost two million square feet of space. Put that in perspective: that's roughly two times the HSBC Tower here in Canary Wharf. Now, interestingly, most of the new stuff that we've gone into is new and relocated branches in places like Mexico, China and Argentina – and, by the way, four in Scotland.

I think the key point here that I want to make is that managing fewer people in a more simplified global organisational structure, managing fewer vendors, fewer buildings, fewer change projects simplifies the firm, makes it easier for us to manage and control and focus on what's really important.

So, let me review in some detail our progress with respect to the four organisational effectiveness programmes. Starting with implement consistent business models, we have implemented standard global business models in 17 key markets across the Group, generated sustainable cost savings of 200 million, reduced headcount by 4,000, and also we focused on improving the revenue per FTE in Commercial Banking and Retail Banking and Wealth Management. If you compare the first quarter of 2011 to the first quarter of 2012, we've achieved a 12% improvement so far. Now, going forward, we will implement the standard business models across all markets, realign our resources to the faster growing markets, and continue to drive this revenue per FTE.

So, for example, we're really working hard to build consistency with respect to our commercial credit review process. So, there's a lot of people who do spreadsheet-type work in this audience and will probably relate to the amount of time you have to invest in that type of process. We're trying to streamline that process to give our relationship managers more time to spend with customers, so that they can generate revenues.

We've piloted a new end-to-end engineering way of doing our credit process in three pilot sites, and it's so far showing a 15% improvement in productivity. In Retail Banking and Wealth Management, we're currently managing a really important initiative to materially rationalise and standardise the number of products that support the target business model. The initiative will enable the business to simplify the processes and systems that support these products, and it will also free up resources for us to invest in more innovative, differentiated products and services for our customers.

With respect to reengineering global functions, last year we indicated that the historical growth of the Group had led to multiple layers and complex structures that cost too much and were less than efficient, and that we intended to simplify, reengineer and streamline those functions. We have so far developed simplified global organisational blueprints. We've implemented those in eight key markets so far. We've generated sustainable cost savings of 350 million and reduced headcount by 3,500 so far. At the same time, we've been able to invest in our Compliance function and doubled our spend from 200 million in 2010 to 400 million in 2011. Going forward, we will complete this de-layering exercise across all markets and focus on process engineering so we can improve the way we do things, such as credit approvals.

Just consider an example of our marketing department: we run a big marketing function. We've historically run it as a federation of marketing departments. We are now well on our way to creating a globally unified marketing function that enables our business strategies and that's targeting sustainable – sustainable – annual sustainable cost savings – I said it three times – of 300 million. We're streamlining and restructuring the department. We're implementing a centre of excellence to lead strategy on things like advertising, sponsorships and the voice of the customer. We are reengineering our work processes in key areas and, therefore, saving costs, eliminating costs. For instance, we're improving the efficiency of the cost of things like TV commercials, which was done sporadically, and posters. We are absolutely sustainably – and I will say it again – sustainably eliminating non-strategic spend in areas such as advertising and sponsorship.

Let me talk about reengineering operational processes. Last year, we indicated that we would leverage best global practices, implement standardisation and good reengineering practices. We have focused our efforts on 30 core reengineering programmes across the Group. We're leveraging customer insight to improve the customer service that we provide. We're considering industry benchmarking, eliminating unnecessary steps, utilising production management-type techniques and technology. So far, these programmes have generated 430 million of sustainable cost savings, reduced headcount by 3,300 FTE, and reduced paper consumption by 9,000 tonnes, or 14%.

Going forward, we will continue to focus on the execution of these 30 core programmes. Our focus is to simplify processes, improve customer service, reduce operational risk and achieve our sustainable saves target. So, one of the key projects is contact centre optimisation, where we are implementing six key work streams to improve service, generate revenue and obtain sustainable cost savings of more than 80 million a year. So, for example, we're consolidating 61 contact centres, back office operations into three global centres of excellence. We're also standardising the way we collect and utilise information. Just imagine the information that you gain when you're speaking to tens and tens of millions of customers. We're gathering that voice of the customer information and standardising and making more consistent the proposition and the customer service that we provide around the Group.

Finally, streamline IT; we are streamlining our IT function to enable our business strategies and to operate in a more focused, efficient and effective manner, such that we are a top performer compared to industry efficiency and quality benchmarks. Now, so far, we've reduced 3,300 positions, generated sustainable cost savings of 280 million, and increased the proportion of software developers that sit in low-cost locations. Compared to high-cost locations, that percent has increased from 44% to 48%.

So, going forward, we will continue to reduce our IT spend as a proportion of the total Group cost from what it was – 14% in 2010 – to 12% by 2013. We'll do that by implementing a global IT organisational structure that's more focused and generates sustainable cost saves of 80 million. We'll also generate a further 100 million from more right-shoring, because we think there's capacity to increase the proportion of resources that are in lower-cost locations. We're also doing a full end-to-end engineering review of our Change the Bank software development capabilities to reduce our change risk but also save costs of 40 million a year. We're reducing complexity in terms of the number of data centres and software applications that we manage. Our objective is to do all of the above by maintaining our industry-leading levels of IT service quality, as assessed by independent benchmarking firms.

Now, I hope you have a sense and that you can see on this slide that, under the four programmes, we have developed a very strong pipeline of actions to deliver our sustainable cost saves' targets. Our pipeline across the four programmes is very robust and it continues to grow every month and, in fact, grew by 500 million in the last quarter. We have a significant number of key initiatives that we believe will allow us to achieve the top end of the $2.5-3.5 billion sustainable saves target and also enable the simplification of the firm.

So, my key messages are as follows:

- We are demonstrating clear evidence that we are simplifying HSBC and we are making the firm easier to manage and control.

- We have absolutely achieved significant momentum with respect to achieving our headcount and cost objectives.

- There is no question that we have a very strong and robust pipeline of initiatives to allow us to deliver the sustainable cost savings at the top end of the range and also simplify the firm.

Thank you very much. We now get to take a break for 20 minutes, so how about 10.25? And then Iain will come back and talk about capital and financial targets. Thank you very much.

HSBC Holdings plc 2012 Investor Day – strategy update
Capital and Financial Targets

Edited transcript
17 May 2012

Iain Mackay, Group Finance Director

Good morning again. I thought one of the most encouraging and pleasing things I heard this morning was the fact that we opened four branches in Scotland, and Sean was able to include them in the same breath as Argentina, China and Mexico. So I'm sure the First Minister will be extremely happy with that piece of news. Thanks Sean. So really three things that I want to talk about in this presentation: really how the performance for the Bank measures up to date – so just a quick retrospective, so not a great deal of time on that – why we're confident that we can keep on track with respect to meeting the targets that we set out last year, and what we're doing to address, clearly, a significant number of challenges that lie ahead of us. To be clear, we are reaffirming the targets that we set out last year.

So anyway, take a quick look at the overall picture. We're on track to exceed the Basel III requirements both from a capital and liquidity perspective. In terms of dividends, we've reaffirmed our approach with respect to growing dividends. Last year we grew the dividend by 14%, and when you put that in the context that between 2008 and 2011 HSBC paid out 27.2 billion in dividends, that made us the second largest dividend payer in the FTSE 100. With respect to capital ratios, we certainly expect to be at the upper end of the 9.5-10.5 Core Tier 1 ratio that we laid out last year ahead of any increase in capital requirements from the changing regulatory regime.

Looking at returns, certainly continued uncertainty in the eurozone and prolonged low interest rate environment really means that what we anticipate with respect to return on equity is at the lower end of the 12-15% range. But as Stuart described this morning, we are confident that achieving that lower range is well within our grasp. There's a clear focus within the global businesses, within our regions, on the effective management and the efficient management of our risk-weighted assets, and the return on risk-weighted assets, to ensure we achieve that return on equity. I will go into that in more detail shortly. There is a very clear focus from our teams, both in Global Banking and Markets and in the United States, on managing down the legacy businesses that we've got, and this is a key element of managing the overall capital position for the Group, and a key element as it relates also to driving the simplification of HS`BC and realising sustainable cost saves. I think one thing that we've been incredibly clear about over the course of this year is that we will be honest and clear about those things that we cannot control, but we'll be incredibly disciplined about those things that we can, and I certainly think that the numbers we have shown at the end of last year, in the first quarter and are talking about today are clear demonstrations of that.

On cost efficiency, as Sean mentioned, we've realised, on an annualised basis, $2 billion worth of sustainable saves through the end of the first quarter of this year, and we'll achieve at the upper end of our cost efficiency ratio, 48-52%, although I think it's fair to recognise that in the short term this relies to some degree on a semblance of stability within some of our key markets. So we have a challenging environment within which to operate, but there's no equivocation about the fact that we will achieve the sustainable saves that we've laid out, and our target range for cost efficiency ratio is, as we stated, 48-52%. So in short, our focus remains constant, and determined to deliver is absolutely unchanged.

In terms of 2011 and 2012 first quarter, the results demonstrate a position of financial strength, and a solid foundation on which to build. Capital and liquidity: we increased the Core Tier 1 ratio to 10.4% at the end of the first quarter, we increased the 2011 dividends to $0.41 per ordinary share – that's a 14% increase – and maintained a strong asset to deposit ratio of 75% – certainly very well placed with respect to Basel III liquidity requirements. On returns we achieved a return on equity on a reported basis in 2011 of 10.9%. Excluding fair value on debt, in the first quarter we had an annualised return on equity of 11%, and on a comparable basis for the whole of 2011, that was around 9%. With respect to efficiency, we booked $900 million of sustainable saves in 2011, a further $300 million in the first quarter of this year and on an annualised basis, $2 billion, so we are well on track to meet – well inside, and as Sean pointed out, at the upper end of our range from sustainable saves.

In terms of capital generation, the Group has a proven record of continuous capital generation. This was continued in the first quarter of this year. The strong dividend growth and a commitment to progressive dividend policy were borne out last year and continue to be the case in the first quarter. And as Stuart indicated,

capital generation enables RWA growth in targeted high-growth geographies and markets, and we're well positioned and able to withstand the impact of increased regulation as it relates to capital requirements.
Now, there is a lot on this chart, but there is a lot to talk about, but there is really only one takeaway. We are very well positioned with respect to Basel III now, and based on our strengths, we will be so throughout the transition process to full implementation in 2019. This chart is not a prediction of future Core Tier 1 ratios, so don't start building it into models. This does not include capital generation from ongoing operations through the transition period, and nor does it reflect any growth in risk-weighted assets from the initiatives that Stuart talked about earlier this morning. This is taking the first quarter balance sheet and carrying through the implementation of Basel III through 2013, through 2018 and factoring in mitigating programmes that we've executed in some regards and are in the process of executing across a number of work streams, most notably within Global Banking and Markets.

The ramping up of the capital requirements in Basel III rules applied progressively are marked in the pale grey, and our mitigating actions in the dark grey. When you compare this to what we told you last year, we've reduced the overall Basel III implementation impact from 90 basis points to 30 basis points over this period. Now to be clear, one of the key mitigants, which we have delivered against, is the sale of the cards and retail services business in North America. That contributes some 50-60 basis points of Core Tier 1 capital. We've also enhanced management actions, primarily focused within some of the Global Banking and Markets businesses, and we have also intensified the discipline around the allocation of capital, very much in line with the five filters analysis, as we've talked about earlier this morning. So based on all that we know now, we will meet and exceed the demands of Basel III.

So, what we show here are the Basel III Core Tier 1 phased requirements. I get a real kick out of this chart, because it shows that at the end of January, or rather for 2012, we should be at 2%, so sitting at 10.4% is relatively reassuring, I think. I think what we've got to keep in mind here is the continuing regulatory uncertainty. It's not really helpful to anybody, but it's there, it's a fact of life and we have to deal with it. I think there are factors coming through Basel III which remain somewhat uncertain, but hopefully we'll get greater clarification over the coming months as CRD4 is finalised. And in fact, we got some relatively good news as it related to CRD4 earlier this week with respect to the composition of the CVA charge. But certainly reflecting on globally significant, systemically important financial institutions, I think it's likely that we should expect HSBC to be at the upper end of that 1.0-2.5% requirement. However, how that's to be applied and when it's to be applied is perhaps less clear at this point in time than we'd all wish.

Another aspect within Basel III is the counter-cyclical capital buffer, which is intended to manage some of the stress as we see rapid expansion and perhaps some exuberance within the economic cycle. Now, it's intended that that would be implemented from 2016 onwards. I'll leave you all to draw your own conclusions as to whether or not we expect to see economic exuberance in 2016, and it may well be the case that a counter-cyclical buffer just simply isn't necessary, or more to the point, simply wouldn't be appropriate. But again, it's something we've got to keep in mind and manage towards. Within the UK, the Independent Commission on Banking clearly presents a few interesting challenges, and frankly there's not a great deal more to be said, based on what we all learned from the Chancellor's autumn statement in December. I think the one thing that we can conclude is that there will be some significant requirements for primary loss-absorbing capacity, probably in the range of 17-20% for UK banks, or banks based in the United Kingdom.

But within this there was some glimmer of hope that there would be opportunity for mitigation, through ensuring that we've got robust and effective recovery and resolution planning, and in this regard the bank has significant resources in place, working closely with the FSA and the Crisis Management Group, which is a small college of key supervisors around the world, led by the FSA, in ensuring that we have that capability and demonstrate what we believe to be fundamentally true: the resolvability of HSBC on a global basis. But in this respect we'll learn more hopefully in the month of June, as we get the White Paper from the Government on how they intend to implement the ICB's proposals.

To compound this, the European zone is not particularly easy on the regulatory front either, and there is lots going on in that regard. There are proposals under discussion around potentially having up to, you know, 10% of nominal liabilities – not risk-adjusted, nominal liabilities – net of equities as a capital buffer. That presents some seriously worrying challenges in that regard, but this is at a very early stage, and much more will come to pass before there's any finalisation in that regard. And equally, they have formed the Liikanen Committee, which if you like is the equivalent of the Vickers Committee, in reviewing the structure and set-up of banks. But again, that's at a relatively early stage. Another challenge from Europe, and the UK, is the question of compatibility of regulatory change.

So, the main thing probably to summarise on this is that we've got to keep a close eye on all these developments, and certainly ahead of these requirements, ensure that we've got a very robust capital position, which is why we aim to be at the upper end of that 9.5-10.5% range of Core Tier 1.

However, with this background set, we're certainly very confident we're well positioned to address any uncertainty within the regulatory landscape. We've got the planned run-off of our legacy portfolios, the disposition and the application of five filters rigorously applied across the businesses, as we've demonstrated this year and will continue to do so, a strong history of capital generation – perhaps the most important element – and a discipline with respect to the allocation of our capital, again in line with the five filters.

Stuart walked through this as little bit earlier, so I won't dwell on this too long, but I think it's important just to reiterate that when you look at this – this is not something that was dreamt up over the course of the last four or five months – what's demonstrated here is in actual fact a reflection of the average over the course of the last five years in HSBC in terms of 50% retained, around 35% in terms of dividends to our shareholders, and 15% in terms of variable compensation to employees. This is certainly an appropriate balance between different business needs, in terms of strengthening the firm and investing for growth, something that's key in terms of what we've talked about this morning, rewarding the shareholders and maintaining our ability to access capital, and retaining the talent we need to compete. That last point is important, and less and less is made of this in the political debate these days, but that point is absolutely critical for the wellbeing of the organisation and the industry as a whole. So, anyway, we intend to maintain this approach going forward, and we think it represents the right balance in terms of how we handle the core capital resources of the Group.

Looking at ROE now, we're certainly confident that we've developed a clear trajectory to achieve 12% in 2013. Nonetheless, there are a few challenges along the way: market stability, or, perhaps more importantly, a lack thereof. There's really little we can do about this except position wisely, be alert to change and manage the risks. Regulatory change and costs I talked about: the bank levy's key, the Independent Commission on Banking, so on and so forth. The impact of key transactions: Stuart made the point this morning that the disposition of the cards business is dilutive in the short to medium term. We recognised that clearly from the outset in terms of addressing through the five filters how we wanted to construct the firm. It is important to be clear that there is a dilutive effect coming from that transaction in the short to medium term. However, overall, the focus is on generating high returns in our businesses and in all of our key markets to achieve that 12% and above return on equity. In each of the businesses, we are targeting to the middle to upper end of the range of return on risk-weighted assets in the medium term. From a Group perspective, to be able to accomplish this we will generate a return on risk-weighted assets in the range of 2.1-2.7%. As we went through earlier, we've got a significant number of our businesses and markets already generating returns above the lower end of that range.

In terms of focusing on how we build these returns in growth businesses – and this is just a little recap of what we talked about earlier this morning – this is really about building sustainable returns across the piece. The robust management down of the legacy and non-strategic portfolio is absolutely vital. I think our US teams, in incredibly difficult circumstances, have done a fabulous job in this regard over the last few years, and there's clear focus on this within our Global Banking and Markets teams as it relates to what remains of legacy credit positions. These legacy assets consume some $180 billion worth of risk-weighted assets, and detract from the overall return on risk-weighted assets of the firm by some 60 basis points. Focusing on our growth businesses delivers the required returns, and again growth businesses is not a euphemism for the emerging markets. It's how Stuart defined it earlier this morning. It's those home markets, Hong Kong and the UK, and the 20 key priority markets for us. Focusing on developing and allocating the resources to grow those businesses in line with the returns we have set out is what helps deliver the required returns.

We will be thoroughly disciplined about the elements we control. Those are simple: deploying capital using the five filters framework; positioning ourselves to benefit from changing trade flows and new hubs of wealth creation; capturing growth through the global business connectivity, against which we've demonstrated real progress in 2011 and in the first quarter of this year; delivering the sustainable cost saves that Sean laid out in some detail, and leading to the simplification of HSBC.

So, how does this break down by region and by business? The emerging market regions already generate robust return on risk-weighted assets inside the ranges that we're targeting. We will progressively redeploy capital to growth in these areas. Europe and the US remain very challenging. In Europe, returns are depressed by certain head office costs, the regulatory regime and obviously European dislocation. Although growth opportunities exist in these markets, they are less likely to attract capital in the short term. In the US we focus on building the Commercial Banking business and the connectivity between Commercial Banking and Global Banking and Markets, while progressively reallocating businesses as the legacy runs off in that market.

Canada is a great example of HSBC's core strengths. North of the 49th parallel we generated a return on equity of 17% last year, and that's fairly representative of what the Canadian business has been able to do over the last number of years. It's a stable, well-defined business that fairly reflects how HSBC is to be structured as we reshape the business going forward. In the global businesses, Retail Bank and Wealth Management has very strong returns, excluding legacy. So I hate to dwell on it, but the importance of effectively managing down the legacy portfolio in the North American business remains a key demand on our management teams in the US. The Commercial Banking business is in the right place, with positive trends. Global Banking and Markets is clearly impacted by regulatory change, but as I mentioned there's a lot of work under way within Global Banking and Markets to define how we manage businesses in that changing regulatory environment. As we write business today, we are writing business that meets the return on risk-weighted assets requirements and the return on equity requirements that we need in this business going forward. So we are already adapting to what we see in terms of regulatory change as we write new business.

So it is important to be clear in this area: we have the right building blocks to deliver the targeted Group returns. Our strategy focus is resource allocation and execution. Delivering against the cost targets is a fairly key element to this as well. Short retrospective here: costs were controlled in the first quarter. There were notable items: this is a feature of the last few quarters, and to be fair, and to be clear, as we move forward, certainly over the next few quarters – as we address some legacy issues, continue to restructure the firm in the manner we've laid out – we'll continue to incur some notable items and will provide the clarity and disclosure around what those are at each of the opportunities that we have at the quarterly, half-year and annual points.

Organisational effectiveness programmes contributed towards significant restructuring charges in 2011, some $1.1 billion. There was an additional $250 million of restructuring charges in the first quarter. There's more to come in this regard, but I think it's fair to expect that over the coming quarters, we should expect to see restructuring charges gradually decline as we work through the remainder of the programmes that we've got laid out ahead of us. Equally important to recognise is that against these charges of restructuring, we've delivered material, sustainable saves – real progress, in effect. The additional $300 million of sustainable saves in the first quarter was on top of over $900 million last year and, on an annualised basis, $2 billion.

The cost focus is delivering a stable, ongoing operating expense base. As I mentioned, notable items are featured, but we'll continue to clearly highlight for the marketplace what these notable items are and how we're managing them. Adjusting for these, the cost base is broadly flat over the last five quarters, demonstrating that we can offset the impact of businesses usual cost increases – perhaps most importantly, investment in growth businesses, but also dealing with inflationary pressures. There's been significant progress on shrinking the headcount, with some 14,000-15,000 reductions since the first quarter of last year, but that does not include the impact of the major dispositions that we closed out on 1 May this year. So I think what this demonstrates is that we are poised to deliver sustainable reductions in the ongoing run rate of operating expenses.

The cost efficiency ratio challenge is not just about costs. If it were, it would be much easier. Revenues are the other side of managing towards our cost efficiency ratio target. Reflecting on this chart, more than 90% of our revenue streams are stable – reliable, if you like – over the last three years, although what we have seen is, in terms of net interest income and fee income in North America Retail Bank and Wealth Management, a contraction of some 14% over that three-year period. However, we've grown net interest income and fee income by 3-13% across Asia, Europe, the Middle East and North Africa, and Latin America, to compensate and offset this effect. The Commercial Banking business has grown net interest income and non-fund income by 12% and 8% respectively over the same period.

So overall we have experienced low volatility over the last three years, but have seen variability in rates and credit, and Stuart went into more detail on that earlier, and on the balance sheet management front I think we have provided reasonably clear guidance about where we expect to see these numbers over the coming quarters. But at the same time, in foreign exchange, equities, payments cash management, we've grown 5%, 22% and 21% respectively over the last three years. We have stable, reliable and growing income flows. This provides a platform to manage and improve our cost-efficiency ratio, and the Group's strong balance sheet provides the basis for driving the growth programme Stuart described earlier, against which we've made real progress. That same balance sheet strength delivers real upside with rising interest rates, and one can only hope that that happens eventually.

Bringing all these elements together, and using 2011 as the basis, there's lots of variability in terms of fair value on debt, non-qualifying hedges, but when you look at how we've guided with respect to performance in a business like Balance Sheet Management, when you reflect on the impact of the key dispositions that we're doing across the business – and what we've reflected here is the impact of disposing of the Cards and Retail Services business in the US: on revenues it contributed $5.5 billion in 2011 and almost $2 billion in operating expenses – these are things that will not feature in the run rate of the businesses, either revenue or costs, going forward.

When you reflect on some of the economic factors from a revenue perspective, as policy rates move, so does our net interest income, and we saw evidence of that in a number of our Asian markets last year; whether it was China, India, Australia, where policy rates moved up, that was reflected almost immediately in our balance sheet management revenues in those markets. Our positioning in terms of our footprint in key growth markets and gross domestic product developments in those markets is another key enabler in terms of driving growth for the organisation.

Last but not least on the revenue front, delivering against the growth programmes that we've laid out, whether in wealth management, whether in the connectivity of the Commercial Bank or Global Banking and Markets, as well as the other business growth opportunities that we have gone through, is a key element to delivering against growing revenues as we move forward. On the operating expense line it's an equally active set of analysis. Notable items – we've gone through that in plenty of detail I think – but in terms of addressing some of the challenges within the business, the delivery against the sustainable saves is at the upper end of that target range, with real discipline and a sense of urgency. It's what we've been driving for the last year, and it's what we'll continue to drive for the future. We need to do this for a couple of reasons: one, simplifying the firm, first and foremost; but also to create some capacity to deal with inflationary influences within some of the key markets that we operate. But also – and perhaps most importantly – to invest in growth, to invest in growth in key markets, in key products, and through that investment drive positive jaws: faster growing revenue than the rate at which we grow costs.

This is about continuous progress towards 48-52% cost efficiency ratio on both revenue and the cost lines. This is not just about between now and 2013, although that is the focus for us at the moment. But this is about building a lasting skill in HSBC, in terms of developing revenue growth and in terms of delivering cost productivity year after year after year, through to 2013 and beyond. We will deploy costs into markets which generate positive jaws – simple as that. On the jaws story, what I lay out here is the fact that within our key growth markets, Latin America, rest of Asia-Pacific, Hong Kong, Middle East, we are generating positive jaws, when you take account for the notable items.

Cost growth in Europe and North America: Europe includes the bank levy, North America includes high regulatory costs and some other notable items that we've discussed, along with greater volatility in certain revenues, particularly within the eurozone, it's driven negative jaws in these markets, but in these markets, as with all our others, the focus is on delivering low costs while meeting compliance and regulatory demands to the highest possible standards. We aim to generate positive jaws in every market and every business. We're already there in our key markets and businesses.

So, to summarise, robust capital strength: it's a signature of the Group. We're on track to exceed the Basel III capital and liquidity requirements, we will reaffirm our dividend growth policy, anticipate being at the upper end of the 9.5-10.5% Core Tier 1 ratio range, ahead of capital requirements, and robust management of risk-weighted assets, and the returns on those risk-weighted assets, are the focuses for the firm. We are making real progress on delivering target returns. We're managing down the legacy businesses, we're driving sustainable cost saves, and that's leading to the simplification of HSBC. There are decisive and significant actions on cost efficiency. We have got annualised cost savings of $2 billion, and building from there. We will deliver at the upper end of the cost save target, and we're maintaining the cost efficiency ratio target of 48-52%. So, with that, thanks for your attention. I think we're going to take questions and answers now, and after we've done Q&A, Stuart will provide some wrap-up.

HSBC Holdings plc 2012 Investor Day – strategy update
Questions and Answers

Edited transcript
17 May 2012

Stuart Gulliver

Thanks, Iain. Okay. Before we start I want to just introduce the senior team, who are in the front row. So starting from the far right, if you could just stand up, Pat Burke is the Deputy CEO of the USA. Irene Dorner, who is the CEO, has just had surgery and was unable to fly. Thank you. Marc Moses is the Chief Risk Officer of the Group. Antonio Losada runs Latin America; Brian Robertson runs the UK, Europe and the Middle East; Krishna Patel, the Private Bank; Paul Thurston, Retail Banking and Wealth Management; Peter Wong, Asia-Pacific; Samir Assaf, Global Banking and Markets; and Alan Keir, Commercial Banking.

The reason I introduce them is obviously they're going to answer all of the questions. So, we've allotted an hour for questions. We have got some people, obviously, on the phones and listening in to it, so I'm going to take questions from within the room and through the phone lines, so if we can start from within the room. Yes, please.

Stephen Andrews, UBS Asia

Thanks, Stuart; it's Stephen Andrews from UBS. You've obviously made a huge amount of progress on cost, which is why there's been such a focus on it today, but I'm just trying to get an idea of what is sort of a gross versus net number. I mean, if I look at the headlines, you've got 2 billion of ongoing cost saves. The businesses you've sold probably are another 2 billion of cost, so net you're down about 4 billion, which is about 10% of the cost. How much of that sort of 2 billion you saved has had to be reinvested either in growing the business or, indeed, in the compliance costs that have gone up a little bit more than perhaps we were all expecting, so if you could try and give us an idea of what a net underlying run rate on costs is.

Stuart Gulliver

Well, clearly, we've had an increase in wage inflation of –

Iain Mackay

About 1.2 billion total salary increase in the last year.

Stuart Gulliver

– 1.2 billion of wage and salary increases and there's about 400 million of increased compliance costs, so the 2 billion is net of those. I think anything else would be getting a bit cute, but those are the big numbers that are going in the other direction that we've absorbed. And I think the absorption of that wage price inflation in the emerging markets is really quite important, because we've managed to retain our staff, meet the wage price inflation and have positive jaws in those emerging markets, so clearly we are getting a return on that investment, which I think is quite important to highlight.

We'll just go backwards through the row, so can we just start at the front here?

Raul Sinha, J.P. Morgan

Hi, it's Raul Sinha from J.P. Morgan. If I can have two questions, please: just to follow up on the cost, then, you've obviously made very good progress on the cost targets that you set out, and we note that a number of your targets around the revenue aspect obviously depend upon increased revenue generation over the next one or two years, which, as you yourself said, are dependent on the market conditions. To what extent would you consider further cost saves if you do see the revenue environment getting more difficult? And could you give us some idea of the flexibility? Because it seems like you've made progress well ahead of your expectations on cost that you said last year.

Stuart Gulliver

I think we would have to be quite careful about driving beyond the upper end of our cost range, because then we would start to disinvest in the fast-growing markets and therefore we would therefore be putting at risk future revenue streams from actually underlying customer business, so as the environment worsens, undoubtedly in those areas where the environment's worsened there will be, if you like, a logical approach, because we will be making less to cut less, but overall for the Firm I would be reluctant to go beyond where we've committed at this moment in time, because I think what we would end up doing is creating a problem for ourselves in a couple or three years' time, where we will be seen to have underinvested in

Asia Pacific, underinvested in Latin America, underinvested in Commercial Banking. So, the cost ranges we've set out are the cost ranges we've set out.

Clearly, in Iain's presentation, if you look at it you can see that there's not an absolute cost target that we're communicating, but you can see where the logic of the presentation leads you, but I think that we will stick to those cost targets and we are comfortable that we'll hit the upper end of the range. I don't want to get to a point where we're disinvesting: where suddenly we can't contain wage price inflation, where we can't invest in systems, where, you know, we can't remediate some of the compliance issues that we have and can't invest in systems and so on. I think we would get to a point of discontinuity if we did that.

Raul Sinha, J.P. Morgan

Good – another one on the US, if I may. Could you talk about the negative fair value on the HFC book? I mean, just around that, how important is that to your exit strategy that you talked about in terms of disposals? Is the US regulator still focused on that, even after the cards disposal gains that you had? If you could give us some idea of the magnitude of that.

Stuart Gulliver

Do you want to take that?

Iain Mackay

I mean, one of the things that we disclose at the end of the year – and since the end of the year it hasn't changed significantly – is sort of a theoretical block trade fair market value for the run-off CML portfolio. And that fair market value discount is somewhere in the range of $12-14 billion.

As Stuart mentioned, I think one of the things we focus on is clearly how that portfolio attracts risk-weighted assets in what continues to be a very difficult housing market. The effect of foreclosures has an impact on risk-weighted assets as well in terms of the timeline of delivering, so I think that factors in to how we reflect on the economics of possibly investing some of the capital released from the disposition of the cards and retail service business in an economically sensible manner, accelerating the rundown for that portfolio. I wouldn't like to put any words in the regulator's mouth – and Pat, maybe you'll add a word here if I step wrong – but they are very focused on how we manage all of our US businesses in a thoughtful, responsible manner, but not least of which – you know the run off of that CML portfolio – ensuring that we've got the right forbearance measures in place and are addressing what was required in one of the cease and desist orders pretty much across the industry with respect to foreclosure practices. So, you know, it continues to be a sharp focus.

Anything to add to that?

Pat Burke

No.

Stuart Gulliver

I think just a couple of things, which is that obviously we are not a forced seller at any point in time, so we've got tonnes of liquidity and tonnes of capital. The 8 billion we have just got from the card business gives some optionality to accelerate it from time to time if those opportunities come up. Otherwise the book reduces by 50-60% over the next five years anyway just by run off, so it's clearly going to be important to us that the portfolio is responsibly reduced and well-managed. So it's one of the factors we take into account, but bear in mind from all of the presentations we've given you, we're under no pressure to accelerate this. My point is simply that surprises in LICs in this portfolio have a disproportionate impact on our share price – or certainly did in the third quarter – so of course it's going to be a massive focus for us going forward. Yes, Robert?

Robert Law, Nomura

Thanks, Robert Law at Nomura. I've got a number of questions around the area of returns. Perhaps – I was looking at slide nine of Iain's presentation where he splits the returns between the growth business and the Group. A number of things around this, and firstly, can you comment on what does it take for the ROE target to be achieved? Are you, in getting to the 12-15, are you building in the effect of rates that you quantified for us during the presentation, because I can see the growth business achieves the 2.2 return on risk-weighted assets target, which would be a high-teens ROTE, but obviously within that you have something like 20% of the Group in the non-growth areas, so as you run those down, unless you expand the profitability in HSBC growth, the effect on the return on equity in earnings terms won't be equivalent to a high-teens or mid-teens number, because you'll be freeing up capital in the legacy businesses. So, could you comment on how you get to a target in your range while you're shrinking the risk-weighted assets?

Stuart Gulliver

Well, first of all, it doesn't contain interest rate rises, so there's no assumption that interest rates have risen in these numbers. And if interest rates rise, that's where we believe we could get to the upper end of the 15%.

So the lower end, the 12%, we reckon we can get to with the redeployment of capital that is released by the run-offs, the cross-fertilisation stuff that we talked about – the couple of billion dollars that effectively we have left on the table by not actually running the Bank as a cohesive set of businesses in quite the optimum way we can do – which, clearly, again, has little incremental cost to actually drive it through, and we are obviously assuming that we will continue to grow our loan books in the emerging markets and there's some growth coming through in the underlying businesses.

So, it's those three things and a combination of those three things that we believe – and obviously the rundown of the legacy books – that will get us to that 12% number.

Robert Law, Nomura International

A couple of follow-ups to that: could you comment briefly on where you think the returns go in the growth businesses? Particularly if rates stay where they are, do you still get incremental headwinds which tend to push down the returns, even if you grow the volume in those businesses? And secondly, you commented, about the release of capital in North America, that you might start to use some of the capital you've got there to accelerate the rundown. Could you comment on how capital-accretive you think the rundown will be? In other words, what kind of losses are you prepared to take as you run that down?

Stuart Gulliver

Okay, for example, right now, any new business we are writing – for example in Global Banking and Markets or in Commercial Banking – is being written in order to generate an ROE of 12% on a Basel III basis. So all new business is already being filtered to be above the bottom end of this target range, so there's also a replacement of business that goes through – you know, fresh business being written is being written at that level. Can we do that against the competition? Yes, we can, actually, because there are clearly a number of banks that are financially a lot less strong than we are that are pulling out of significant areas. The European banks' share of structured trade finance in Asia is reduced dramatically; we've picked up some of that slack. So, there is absolutely pricing power in new business to write new business that's comfortably above the 12% ROE. So I don't necessarily think that volume growth comes at narrower margins. I think it's actually possible for us to get volume growth – and indeed we're seeing it in Global Banking and Markets and CMB – that's comfortably inside this sort of target threshold.

As for the attempt to accelerate some of the rundown, the honest answer is it will be an optimisation of effectively the opportunity cost of keeping the positions and the capital to keep them. It's an NPV calculation, logically. I mean, what does it cost to get rid of this thing versus what does it cost to hold in terms of the capital you have to put against it, so it's going to depend on where prices are for property and also, by definition, it's going to depend on some demand from non-bank investors for it. But it's exactly the same calculation as we set out on the slide after the CML one about Global Banking and Markets. It's simply an NPV calculation of capital costs versus disposal against a pool of money that we have in the US. That pool of money will also be used, though, to build out the Commercial Banking business, because by definition we will need to be a well-capitalised bank in the United States to build out that sort of fresh business, but there's no kind of cookie-cutter answer to the disposal of portfolio. It'll be tranche by tranche on an NPV basis of capital required to hold it versus loss against the buffer that we've effectively got.

Michael Helsby, Bank of America Merrill Lynch

I've got three questions; it's Michael Helsby from Merrill Lynch. Firstly on the margin or the interest rate impact, can you just clarify that 7-8 billion? Is that a net number or a gross number, i.e. is it net of the higher funding costs and the asset spread reduction that you'd probably face if rates rose?

Second question is just on costs, and I've got no doubt from what you've said that you can achieve the higher end of your 3.5 billion cost savings. The more difficult question for me is – I think as one of the questioners asked before – is trying to get to that underlying pace of cost growth, because if I look at your base level of costs in 2010 and clean them up, and then I look at your costs in the first quarter and clean that up and annualise it, then it looks like the run rate on an annualised basis is about 5%, give or take. So, is that 5% a sensible level of underlying cost inflation we should be thinking about or is it materially lower than that? So that's question two.

And question three is just looking at Europe. It looks like you've actually restated the return on risk-weighted assets target. It's changed at a Group level, so I don't know if you could give us the split by business and geography again, but in Europe you'd used a target, 1.3-1.8% of return on risk-weighted assets. Again, if I clean up the first quarter of 2012, which had just 31 basis points of bad debt in it, which is clearly very, very low, then your returns are just about 1%. Actually, about if you seasonally adjust that and adjust for Basel III, it's more like 0.7. So I guess the question is: I get the Latin America; I get the profitability of the emerging markets franchise; but I really, really struggle with Europe and I wonder what you're going to do specifically to improve those profits, which need to almost double to get to that target range.

Iain Mackay

So, how about if I go through the mechanics on the range and then...

Stuart Gulliver

Okay, I'll start with Europe and then we'll reverse back in. So, Europe contains the entire cost of the headquarters of the Group; it contains the entire bank levy; it contains the difficult year in Global Banking and Markets, because our big two dealing rooms are in Paris and in London. If you look at the underlying UK retail bank, Commercial Banking and Retail Banking and Wealth Management, the ROE is 17-18% of that business. If you look at the Commercial Banking business in France – although modest – it has had 30% growth for the last three years each year as it's focused in on trade finance and international business between French SMEs and other parts of the world.

So if you take away those big distorting factors, the underlying UK retail banking business is great. It's extremely profitable. So, if you then say, 'Well, there's the cost of the headquarters; possibly, geographically, we should show it as a separate item, but it distorts the European numbers,' and we have chosen – because it is a specific cost of being headquartered here – to apply the entire levy to the UK operation. So Europe is nothing like as negative as you see it once you reverse those things out. On cost, actually the cost growth number is lower than the 5% that you're talking about. I think we gave some pretty heavy indications as to where we are trying to get the cost base down to, and it is clearly an absolute lower number than the one we started with at the beginning of 2011. And I have to say I didn't understand the question on net interest margin but Iain obviously did.

Iain Mackay

Let me try and sort out the net interest income one. I'm not quite sure where you're getting the 7-8 billion, Michael. Sorry?

Michael Helsby, Merrill Lynch

I thought that's what you said.

Iain Mackay

No, sorry. That's not what I said. If we talk about net interest income, upside – and this is something we talk about in the annual reporting accounts – we've factored in – not in any of these numbers, but what we've sort of simulated across our deposit base – that if there were four consecutive 25 basis point increases in the US rate that would represent an add to net interest income for the Group in the range of $1.6-1.8 billion, right? So, there's the real number, so if I misspoke I apologise, but that disclosure on how we do it is sitting on page 155 or something in the annual reporting accounts. So that's really what we see as upside, but to be clear we've not factored in interest rate increases in any of the numbers that we've put here, and we don't plan for that in terms of how we do detailed planning at a legal entity and business level.

The other thing I would talk about in terms of the ranges, when you talk about that range moving for Europe and, frankly, for businesses, we gave a fairly wide range last year, and we based that on a 9.5% Core Tier 1 ratio. So if you're going to hold capital at a 9.5% Core Tier 1, the sort of bottom end of the range corresponded to 9.5%, give or take. Our view is that we need to be at the upper end of that range with respect to capital, Core Tier 1, and as a consequence of which the ranges that are set for businesses and regions have done a sideways shift upwards, so we've taken out the bottom end of the range and moved it up and the top end of the range, if you notice, has moved up ever so slightly to recognise that, over time – hopefully with the help of interest rate movements which reflect through in terms of net interest income – moving to the higher end of that range or through the range would require, obviously, higher return on the risk-weighted assets, written at a geographic, and within those geographies, the global businesses.

So as you try to triangulate back to last year's ranges versus this year's, it's really informed by the fact that we would hold a higher Core Tier 1 ratio.

Michael Helsby, Merrill Lynch

Thank you. That's helpful. Can I just come back to Stuart on the Europe question?

Stuart Gulliver

You can have one more and then I think we need to give someone else a turn.

Michael Helsby, Merrill Lynch

I think you misunderstood my question because I appreciate that the underlying profitability is good in the UK. I guess when you set your targets you knew about the levy, you knew about the head office cost, and yet you still set your target at 1.3-1.8%.

Stuart Gulliver

Yes, because you have got abnormally weak Global Banking and Markets performance in the numbers.

Michael Helsby, Merrill Lynch

I've annualised the first quarter, which actually I think you'd recognise was actually quite good, and also you had bad debts of 31 basis points. I think there's two points in the last 50 years when it's been lower than that. So I'm looking at the first quarter, and still to get to your target you need to almost double the profits. Is that target just the wrong thing for us to be looking at, I guess?

Stuart Gulliver

I guess what you might want to do, therefore, is to take the levy out and apply it to the Group, and the Group headquarters costs out and apply it to the Group.

Michael Helsby, Merrill Lynch

Okay.

Stuart Gulliver

Because you're applying them in one geography.

Michael Helsby, Merrill Lynch

No, I appreciate that, but your target applies to one geography. So is that target just the wrong target and therefore you need to restate it, adjusting for the levy and the head office costs? That's what I'm trying to get to.

Stuart Gulliver

Okay, well I understand what you're saying. We'll look at that granularity point.

Fred Thomasen, Goldman Sachs

Fred Thomasen from Goldman Sachs. I have two questions on costs, if I could. The first was just to try and check my understanding of slide 11 from the financial targets presentation and whether it's true to conclude that basically both in 2011 and for the first quarter of 2012, the restructuring charges that you took basically offset the cost savings that were delivered by the cost-savings programme, and that net the impact to your reported costs was just about zero in both periods and, therefore, assuming that you deliver on the cost savings range, all of that has still got to flow through to your reported costs.

Stuart Gulliver

Yes, that would be correct.

Fred Thomasen, Goldman Sachs

My second question was just on slide 14, and I'm simply trying to square the circle between – so you note, 2011 operating expenses reported of 41.5 billion. If I strip out the notable items and the various other items that you list there, which, as far as I can tell, it is essentially known they will take place over the coming years – certain things will not recur; these assets have been sold. Now, if I strip those out I get to a cost range underlying of $35-36 billion. Now, I am just trying to square the circle between that, which I interpret as a sort of 2013 indication versus consensus, which I think right now stands at 40.1 billion for 2013, so about 4 billion higher and 41.5 billion for 2014, so about 5.5 billion higher. I'm wondering if you could help me square that circle.

Stuart Gulliver

Would you like to have a go at helping Fred square that circle?

Iain Mackay

Yes. I've never understood that term, actually, squaring a circle, as it sounds geometrically impossible, but I'll try and help you, Fred. I don't know how you guys have done your cost models, right, but when we've reflected on this, we have looked at the reported items, we've looked at non-recurrings – and some of the non-recurrings, to be clear, are recurring. So the bank levy is here to stay, so we don't factor in the bank levy as one of our notable items going forward. It's got to be in the run rate, right? Significant restructuring costs clearly generating sustainable saves are, if you like, the gift that keeps on giving, and we'll continue to build on that. We have already increased compliance costs significantly across the Group. They've almost doubled over the last three years, and purposefully so.

We've talked very openly about the fact that we've got a number of cease and desist orders in the US, like other players in the industry, which will almost certainly result in fines or penalties of some regard. We budgeted nothing for them because we have no idea how they're going to play out. So, in terms of giving you an absolute cost number, it would be a fruitless exercise, because neither you, I, nor anybody else in this room will know where that cost number runs out. But the sole purpose of the slide on page 14 is to try and bring to people's attention what we think are those items which – even if they're recurring for one or two quarters – will eventually come out of that underlying cost base. We take out of the effect of dispositions, and we've modelled only the effect of the CRS sale in here, and hopefully that guides people to give you a range within which we would expect the underlying sustainable operating expense base to be, and I would be so bold as to say we would expect it to be low. You know, like Stuart said, where we started – we started with a cost run rate of 40 billion. We expect it to be below that, and the more we deliver against sustainable saves, we'd expect to be substantially below that.

Stuart Gulliver

I'm going to take one from the call, so could we just have Mike Trippitt of Oriel Securities, if the technology works?

Mike Trippitt, Oriel Securities

Morning.

Stuart Gulliver

Morning.

Mike Trippitt, Oriel Securities

I just wanted to follow up on slide five of Iain's pack, which is the sort of update on the impact of Basel III. If I think forward to the ROE targets, the 12-15% range on a 12% Core Tier 1, if one sort of hypothetically assumed that risk assets don't move, then I think that's about 1.5-5 billion of additional attributable profit. The bit of the equation that's missing for me at the moment is just trying to understand what you think the growth impact would be on risk assets going forward. I don't know if you could help with that.

Iain Mackay

Well, I think what we've laid out here in the first box to the right of the 10.4 starting point, Mike, is what we think the effect is of implementing Basel III on risk-weighted assets, which we think is 110 basis points, coming from the CVA financial correlation, securitisation and free deliveries. Okay?

There's also the effect of early implementation of securitisations, weighted at 1250% and the reversal of the tax credit for expected losses, so, in total, if you like, 1,200 basis points of impact of implementing those elements of Basel III on the risk-weighted assets of the Group. That's the capital effect of implementing that against the risk-weighted assets of the Group.

Mike Trippitt, Oriel Securities

So you're saying that's the pure risk assets. I'm just thinking whether there's some capital impact in there as well. I was just trying to separate.

Iain Mackay

Well, there are capital and RWA requirements, but those are the main effects coming from risk-weighted assets changes. There are clearly capital elements which phase in really later in the phase-in process, post 2013, which are highlighted as 80 basis point effect, threshold reductions, restrictions, minority interest. Now, that's what we've laid out here in gross terms for you in terms of risk-weighted assets impact and then threshold and capital deduction elements.

Mike Trippitt, Oriel Securities

Okay, thank you.

Tom Rayner, Exane BNP Paribas

Thank you very much; it's Tom Rayner from Exane BNP Paribas. Could I have two questions, please? The first on the cost income ratio target. Stuart, you mentioned achieving 12% ROE, the bottom of the range, doesn't require any increase in interest rates, so I assume achieving the 52% upper end of the cost income ration neither requires increased interest rates.

Stuart Gulliver

Correct.

Tom Rayner, Exane BNP Paribas

It sounds as if the commitment to achieving this range in 2013 has been dropped, or certainly downgraded to some extent. Maybe that's my misinterpretation, but it sounds as if maybe we should be thinking about this as a medium-term target rather than as a hard target for 2013. I wonder if you could comment on that, and I have a second question on Basel III, please.

Stuart Gulliver

So, we're staying to the commitment to hit the 48-52. We will stay with the commitment to do it by the end of 2013, but obviously there are certain things that are not in our control, so immediately after this same event last year the eurozone got into deep difficulty. If you recall, the US was downgraded from AAA; it came close to not getting its budget approved and the whole government ceasing to operate. Those types of things I can't control, so to reiterate what Sean and Iain have both said: those things that are within our control, we will control; those things that clearly are less in our control, it is very difficult for us to get our hands around. We're not going to back off this because it actually is the right target range for this Firm to operate in because it will be and is a massive emerging market player and, eventually, the way we get to the bottom end of the range comes as interest rates move up. But the top end of the range is not assumed to be on the basis of interest rates moving up.

Now, clearly what I'm also saying, therefore, is that if we do find that something difficult happens in Greece fairly shortly that spills into Spain, it would be unreasonable to assume that the world hasn't changed at all. But no, we're not abandoning this, and no, we're not moving away from the end of 2013.

Tom Rayner, Exane BNP Paribas

Okay, thank you. I just note that consensus is closer to 56.

Stuart Gulliver

Yes, consensus is around 56.

Tom Rayner, Exane BNP Paribas

Yes, okay. Just on Basel III, just on Iain's slide six, looking at the sort of fully loaded, I guess, January 2019, including the maximum counter-cyclical buffer, there is a sort of minimum of 12, but if we ignore that it looks like 9.5. I just wondered if you could comment on that vis-à-vis the sort of final compromise text of CRD4, where it looks as if the UK and Sweden managed to get their way and argue for national sort of systemic risk buffers maybe as high as 5%. I think there are a lot of hoops to jump through to get that, but it does look as if that's in the text. Can you comment on that and how that sits with the chart on slide six, please?

Iain Mackay

I think what came through on Monday or Tuesday morning, if you like, the 5% related to domestic banks, and I think the 3% was sort of the international banks headquartered in the UK. That's predicated on the basis that the UK Treasury or the government wouldn't have to go back and seek approval from the Commission, the Parliament – or whoever the hell makes these decisions – to do that. In terms of if that's what ends up in the final text remains to be seen, but I think the Chancellor got what he wanted, which was the desire to push capital requirements on UK banks higher than that required either by the Basel III regime or, for that matter, the focus of the European regulators.

Stuart Gulliver

Although, Tom, in the other direction, there's some uncertainly around whether the CVA charge will come through in its current construct as well, which clearly would have a positive impact in the other direction.

Tom Rayner, Exane BNP Paribas

I was just trying to get sense whether there was any overlap in what they describe as G-SIFI buffer and what's already there as D-SIFI and –

Stuart Gulliver

No, Tom, everything's additive in the world of regulation.

Iain Mackay

It's a great question; it's a question that we've posed to regulators on a fairly regular basis about, 'Could you please help us understand how these buffers are going to work? How that's going to interact with individual capital guidance and capital planning buffers in the UK?' And the regulators are working on it. You know, I think until CRD4 settles down later this year we've got a bit of waiting to do on this front, and when we know it you'll know it, and we'll go from there.

Tom Rayner, Exane BNP Paribas

Thank you very much.

Ronit Ghose, Citi Investment Research

Hi, it's Ronit Ghose from Citigroup. Stuart, you mentioned how economic growth is in the south and the east already, and your revenues and your earnings – particularly your earnings – are there. But when I look at your balance sheet, whether it's deposits, loans or capital, it's still very developed market-focused. Are there any forward-looking comments you can make about how that weighting will change? Because you talk about the need to get the valuation up, but as long as more than half your capital or two-thirds of your loans are sitting in developed markets, I guess that's going to be a headwind. Any comments on that?

The second one is more a question, really, related to – through the presentation you made a lot of comments about by simplifying the Group it helps the control environment. You have obviously got two very successful associate investments in mainland China. Those are growing rapidly; I think about 15% of your earnings come from those two associate investments. Could you talk around the process of your thinking about how comfortable you are as they get bigger and bigger as part of your effectively economic capital at risk?

Stuart Gulliver

Sure. So, in terms of risk-weighted assets and the split between developed and emerging, it pays to look at it from an RWA point of view, not customer advances. Because the very big dealing rooms are in London and

Paris, that's where a lot of the balance sheet management/liquidity management takes place. So, you know, $153 billion left the central banks – there's a different point whether this is right – clearly carries with it a risk weight. So actually the amount of capital that's being deployed, if you go down to the risk-weighted numbers, is not the way you've just suggested. The actual balance sheet footings look that way, but actually it's not actually the way the economics work, because there's a substantial amount of government debt, bills agencies, central bank placings, all of which basically inform a lot of the bulk of the Global Markets, BSM numbers that sit within Europe and sit within the United States.

Clearly, as you saw in one of the slides I put up, 63 billion of RWAs last year went into the growth countries, but that's our definition of growth. So that's the 20 countries, which includes, by definition, some developed world countries. The USA is a growth country for us; the UK is a home market for us. So, as I say, we need to be careful about nomenclature here.

As for Ping An and BoCom, this is a very good question. We have representatives on the board of BoCom and on the board of Ping An, and obviously we have continued to work and build a very close partnership with BoCom. Maybe I'll just ask Peter to run through the types of activities that now take place between HSBC and BoCom, which will indicate several of the touch points that exist between the two firms, which give us, you know, some comfort of the fact that we understand what's going on within that bank. Peter, if you just want to talk about BoCom.

Peter Wong

As far as Bank of Communication is concerned, we have a joint venture of credit cards with them. At this point in time we have about 23 million credit cards. We have about 17 of our staff working in Bank of Communication: some in cards, some within the bank. And at this point in time we also have about 60 projects going on with Bank of Communication. We support each other in China; they support some of our RMB funding, interbank funding, and we support them in US dollars overseas. We also help their clients, where in China's 12th five-year plan, a lot of the companies are going overseas. We help their clients to move overseas in some of the countries we have a strong presence in, like Brazil and the Middle East. Also we have hooked up our systems, so customers that have both businesses with Bank of Communication and HSBC, they can see both accounts on their screens, so we have our systems hooked up. So, these are some of the things that are going on right now and there are many others at the branch level.

Stuart Gulliver

Thanks. Alastair

Alastair Ryan, UBS

So, I'll probably come in on the same question as Tom but from a completely different, opposite direction. So slide seven of Iain's piece, which I know was in the annual Report as well, but if you're already at 10.1% Basel III, you know, when we get there, 50% retention looks awfully high, and paying 15%, the variable pay piece, in stock to staff is obviously dilutive as well; so, I mean, it's a part of the capital management. So just why there isn't more distribution and less retention and less share issuance, as it were, in the plan – and I appreciate how mind-boggling the regulatory environment is today, but as a medium-term plan, the 2011 benchmark would seem sort of – not intuitive is the way you'll be running the bank, because you'll end up with a much higher Core Tier 1 unless you put an awful lot of growth through the business, given the level of profits you're generating.

Stuart Gulliver

It's a legitimate question to ask, but the problem is there's such uncertainty around the regulatory environment that we don't have sufficient clarity. I think you were out of the room when I went through this particular slide, but when I talked about the disposals we made, I also said that we were very unlikely in future to do the somewhat random acquisitions that HSBC typically did every year. So every year in the period 2000-2010 we tended to buy 10 things every year, which tended to add up to about 4.6 billion, and what I said was that the only three we've done – topped up BoCom, Oman International Bank and Lloyds branches in the UAE – they're going to be basically things that pass the five filters. Therefore what I was indicating is, if we eventually get to the stage where we've sorted all the capital out, then obviously we would be looking to return to our shareholders, and that's where the progressive dividend accelerates, but that's a long time in the future. I don't see a situation where we'd ever be buying back shares; I don't think the regulatory environment will ever allow us to do that.

But we are very much committed to a progressive dividend, but we don't have line of sight on it. So even if you look at the ICB stuff, so primary loss-absorbing capacity, 17-20%, you know what the problem for us is: we have an AD ratio of 78. We have deposits; we don't have bonds. So, to hit the primary loss absorbing capital through bail-inable bonds we'd need to issue $55 billion of bonds, which, of course, is leveraging the Bank up, which would result in the ratings agencies downgrading us, which is obviously a smidge unintended.

So therefore we've got to think of some other way to deal with this, because what we also cannot have is a situation where we are less well capitalised than others. We still stick to the well tried and tested HSBC view that we want to be broadly better capitalised than most people. So that probably means, once there's clarity under CRD4, we'll issue some form of CoCo or something similar, because it seems that banks like your own, which are deposit-funded – and so is Credit Suisse – have tended to go to some form of contingent capital to deal with building up their capital buffers. So there's sufficient uncertainty around but it's very difficult to get to this point.

Now, the variable pay and the dilution of the variable pay of issuing shares is a regulatory requirement, so again that's a response to the financial crisis – of holding people's feet to the fire. There is very little flex room in terms of paying compensation out in anything other than stock deferred for large periods of time subject to claw-back. So that I think is with us, as it were. But to your point, we need to get a position where there is clarity, including the PLAC part, which also then means we've had clarity on where the ring-fence goes, etc., before we can get to the situation you're describing. I absolutely can see what you're describing. I can actually easily foresee a situation you've just – actually I would welcome seeing a situation you've described. It would be rather pleasant, but I think it's a couple or three years out, quite honestly.

Chirantan Barua, Sanford C. Bernstein

Hello, this is Chirantan Barua from Sanford C. Bernstein. I have two questions: one on GBM. Given that you are one – you're a global bank, big balance sheet, good counterparty rating, and the fact that you've got lots of capital in the US right now, could you guide us as to what exactly are you doing to grow your share with multinationals in the US who make more money outside? That's one on GBM. The second is you're doing a lot of organisational restructuring and you have tonnes of liquidity on your balance sheet. It would be great to get some transparency around how you're managing your deposits across different currencies and jurisdictions.

Stuart Gulliver

On Global Banking and Markets, this sounds like a rather silly answer, but last week I was in the States and I saw the CEOs of Xerox, GE, Kraft and TD Ameritrade. So we are absolutely covering CEO to CEO level, as you would expect us to do, the big American multinationals, where we will be paid outside the United States, and that's what we do everywhere. I mean I do the same thing with Volkswagen. Next week I'm having dinner in Hong Kong with Carlos Ghosn of Renault Nissan. It's just the way we do this, so absolutely rest assured that's what we do, and Samir does the same thing with CEOs and CFOs.

As to our liquidity, we manage our liquidity on a very, very conservative basis. So, we don't tend to use swap markets to take liquidity from one currency to another, so we have a different model than some of our competitors. So our liquidity in ringgit is kept in ringgit in Malaysia. We don't swap it out and use it to fund sterling mortgages or anything similar. We assume that with the exception of, frankly, the kind of G3 currencies, that forward markets may not work. The only exception to that would be the Hong Kong dollar because of the peg, because we believe the peg is here to stay. And so we run a very conservative approach to liquidity management. It tends to stay within its individual countries. Balance sheet management, which obviously looks a little bit like – so, I might as well tackle this here – J.P. Morgan's Chief Investment Office, in the sense that it invests the $350 billion of surplus deposits we have over loans, actually is quite different in what it does. First of all, it's different in its governance. So the balance sheet management activity is run by Thierry Roland, who's here in the audience, and he reports to Samir Assaf, who runs Global Banking and Markets, and to Iain Mackay, our CFO. So, if you like, there's four eyes' oversight, and there's oversight both of the market risk that's being taken from Samir and there's a governance oversight from Iain.

The second thing about our balance sheet management activity is it really is liquid and it really is straightforward non-credit risk. So, let me explain. We invest most of these deposits in government bonds and bills, in agencies and some with undoubted banks. Balance sheet management does not take credit risk. It does not synthetic credit risk; it does not take underlying credit risk, if you like. What it does do is it takes interest rate risk, so it is managing maturity transformation, which of course is at the heart of what banks do. So therefore it does take interest rate risk, and it uses plain vanilla interest rate derivatives to do the maturity transformation. So it does use interest rate swaps and it does use caps and so on, but it is a very straightforward activity. And also, the third thing that's different about ours is we've shown you balance sheet management for about five or six years now, because we broke it out at least five years ago when I was running Global Banking and Markets – 2006, was it?

In 2006 for the first time – thanks Samir – so six years ago, we broke this activity out because we disclosed, 'Here's foreign exchange, here's rates, here's equities, here's balance sheet management.' So, it's been, if you like, correctly valued – whatever the correct value for it is – by you guys for at least six years. So it isn't that we've had this activity and you've not known about it, so it is quite different.

Yes, can we come down here?

Arturo de Frias Marques, Santander

Thank you. Arturo de Frias from Santander. A couple of questions, please, as well: one, I'm afraid, back to returns versus regulation, back to slide nine on Iain's pack. If I understand correctly, the Basel III raised with the assets inflation story and the mitigation of it. Most of the RWA inflation is going to take place in what you call 'growth HSBC', but most of the mitigation of that is going to take place outside of 'growth HSBC', in divisions that are being run off, disposed of, etc. So, when I look at the 2.2% return on risk-weighted assets that you have on your slide nine and I try to figure out what is going to be that number on a Basel III world, I have the impression – again forgetting about any interest rate increases – I have the impression that that number can only come down in the next few years because of these RWA's inflation that is taking place within 'growth HSBC'. And then if I look at the next slide, and I know you have had already a few questions about the returns of Europe, when I look at the slide 10 and I try to figure out in which areas of 'growth HSBC' return on risk-weighted assets is going to come down, I end up with North America and I end up with Europe, which already have the lowest returns within 'growth HSBC'. So, is this appreciation right? And if yes... Well, I know this is going to sound a bit naïve, but if Europe and the US are going to keep on diluting the returns of HSBC, and maybe in the new regulatory world there are going to dilute the returns even more, what's the point? I know that you have answered this question many, many, many times, but still it is very clear that the returns of the Bank are being diluted by your presence in Europe and the US.

And then a much quicker question, also on regulation: given the stance of the UK regulator and given what we just heard in Europe about CRD4, etc., how likely do you think it is that you will still be allowed – that all the UK banks will still be allowed – to have a transition period 2013-2018? Because when I look at what's going on and what regulators have in mind, I think the likelihood of that transition period never existing or not existing in the future is clearly increasing. Thank you.

Stuart Gulliver

So, the second question first: I think that you're right and I think that the UK regulator, because the UK – you saw the governor's remarks yesterday – is extremely fearful about the Eurozone and therefore will insist on the UK banks being Basel III 2018 or 2019 compliant at the end of 2013, or as soon as they possibly can, which is what the FPC comments about the UK banks needing to raise capital are about. So, yes. I think the UK will accelerate the period by which its banks would need to be compliant. We have modelled this and we're comfortable that we can actually get to the number that the UK authorities will require.

Now, in terms of North America and Europe and the dilution, the honest answer to your question is, of course, we will continue to run the five-filter process on every operation. With the European operations, the French business was impacted negatively by Global Banking and Markets last year. So far this year, in the first four months, it is performing well and has returns that are very comfortably within the rage that we need them to be. The UK business, we need to see what the ICB final report is, because it's unclear to me whether we'll end up with two operations, both of which are excellent and have ROEs above the cost of equity, or no operations that have ROEs above the cost of equity, in which event, you know, we'll have to think long and hard because the five filters apply everywhere. They're not geographically sort of specific – or they're geographically neutral, shall we say.

And the same would be true in North America, but we actually are confident in North America that we can get a Global Banking and Markets and Commercial Banking business and actually can make decent returns. So in North America and Europe there is a tonne of restructuring ahead that clearly has to take place in both those operations. The only reasons that we haven't put the UK pieces, one of restructuring priorities, if you like, in the activity for this year is that we don't know yet until we actually get to the White Paper, so there's not a lot of point in having a large slide with 20 different hypotheses on it, but these will need to be restructured. If they can't restructure, it will make no sense for us to deploy shareholders' equity where we can't get returns.

Iain Mackay

If I could have maybe a couple of points on this, Stuart, as well. You talk about risk-weighted asset inflation. Where the risk-weighted asset inflation is occurring is within certain businesses within Global Banking and Markets, and Samir and the team are putting huge amounts of effort around a number of programmes to mitigate that risk. Well, some of it's risk; some of it's real. There is some good regulatory news out there. What came out of the European Parliament on Monday around a slightly less harsh interpretation of CVA is encouraging. So, you know, that probably moves in the right direction and at a very rough pass through our models, that's a clear benefit to us in terms of RWA inflation.

The other area where we've got RWA inflation is in the run-off portfolio in the US, and that's just by virtue of the foreclosure markets in the US and the performance of the property markets there. That's a rundown business, so there is a declining and rebalancing aspect, but what we also said is that as we write new business today – whether it's in Hong Kong, whether it's in the UK, whether it's in France, whether it's in Samir's business or whether it's in Alan's business – we're writing business that meets the requirements from return on risk-weighted assets perspective to self-capitalise at a higher capitalisation level. So this is not about taking risk-weighted asset inflation and living with it. It's about looking at what we need to do to generate returns on risk-weighted assets that meet the capital requirements. It's complicated by the fact that we've got legacy credit and a CML portfolio that will take some time to run down, and in recognition of the fact that that's going to take some time to run down, we've got to be able to generate better returns above the lower end of the range in those other businesses. But what we're not experiencing is RWA inflation in markets like Hong Kong, in markets like Latin America, because there's not that same regulatory pressure on trade, for example, although if there was news around that, it's probably positive as well in terms of where it's moving. So there's growth, but that growth should be self-capitalising under a new capital regime. It's a little bit different to inflation. Okay?

Rohith Chandra-Rajan, Barclays

Thanks. Two question as well, please. The first one hopefully pretty quick – just trying to make sure I fully understand some of the answers to the previous questions on costs. So going back to Iain's slide 14, if we add across the bottom lines I think we get to 34.7 billion pro forma. You suggest we should add back the bank levy; as you say, it's pretty much an ongoing charge, so 35.3 billion pro forma costs. And then just to check, you think we should inflate that by less than 5% a year in terms of underlying wage inflation and investment spend? So that was the first one.

Secondly, Stuart, you invited us to ask you about the Wealth Management uplift, so the 3.7 billion. Just wondering how much of that is related to market growth and how much is market share or other sort of acquisitive benefits. Thanks.

Stuart Gulliver

Take the costs and then Paul can actually talk to the wealth stuff.

Iain Mackay

The great danger of ever putting a slide like this in the deck is that you guys add numbers up and take them incredibly literally, but that's what you're paid to do, I guess. Look, this is in there as guidance. It's about how we think about the development of the cost base. It is not a projection of what the cost base is going to be at the end of 2012 or 2013. I hope it provides you with a framework within which to think about how costs might develop within HSBC.

Stuart Gulliver

So, on the wealth piece, just bear in mind that 4 billion of additional revenue is less than an additional $1,000 wealth revenue per client. So it's not quite as ridiculous a number as, obviously, you might be thinking – that's perhaps an unfair comment on my part, so apologies – and the fact that we've got pickup of 300 million in a market where it's completely risk-off and we've just started it, I think is pretty encouraging, but Paul, do you just want to talk through the detail?

Paul Thurston

Thanks very much. When we set out our Wealth Management target of 4 billion revenue, we recognised that we had a fantastic customer base, but we weren't really penetrating them particularly well in terms of servicing their Wealth Management needs as opposed to their banking needs, and the target was based primarily on our ability to provide a broader range of services to our existing customers. So it doesn't rely on us going out and acquiring, and in fact last year we stopped and pulled away from the acquisition target that was forcing us just to chase volume of business rather than working more closely with our existing customers. It was a medium-term target, and that's because we recognised we needed to make a substantial investment if we were going to be able to do that, and that investment programme has been under way during the course of the last year. We're investing in better tools for our RMs to do risk profiling, to do needs analysis; better simulators for customers; better portfolio reports for customers; better information; better market information; building out the product capabilities; building out the licensing that our staff have, the training they have. So it's a significant investment programme, most of which hasn't rolled out at all yet – hasn't been deployed. It starts getting deployed across some of our markets in the second half of this year into 2013, so that the growth we're achieving and we achieved in the first year was without the benefit of that investment and in a period when retail investors were pretty cautious.

In our 4 billion target we also didn't include deposits, and at a time when retail investors are staying pretty conservative and holding money in cash, we're taking no benefit for the fact that we're growing our deposit base with Premier customers. They just haven't taken the investment decisions yet, so we never expected the momentum to the 4 billion target to be a straight line; we expected it to be a progressive build as we rolled out the platforms, rolled out the services to our customers, and I would say where we are at the moment is we're on track for that, and we're still confident that we can achieve the 4 billion revenue target in 2015.

Stuart Gulliver

Thanks Paul. We've got time for two more questions, so the gentleman there.

Chris Manners, Morgan Stanley

Thank you very much. It's Chris Manners from Morgan Stanley with just a couple of questions. So I was just trying to look at, in Sean's presentation, slides nine and 15, just trying to work out the difference between the sort of sustainable savings that you've booked and the sustainable annualised run rate, the 2 billion and the 1.2 billion. Just basically trying to work out what is in the Q1 run rate across savings and what we should deduct. On slide nine you've got a 2 billion annualised saving rate, I think.

Iain Mackay

Yes, that's right.

Chris Manners, Morgan Stanley

And then on slide 15, in the sustainable savings booked, it's 1.2 billion. Just trying to work out what –

Iain Mackay

So, what's booked – so what's actually being realised – coming through the P&L, in the general ledger, through the end of the quarter: there was just over 900 million in 2011 and just over 300 million in the first quarter. So that's what's appearing in the ledger. So, these are sustainable saves; it's not one-offs where we sort of cut out the FT for a couple of days. This is the gift that needs to keep on giving, so it's annualising what we realised in 2011 and annualising what we realised in the first quarter of 2012, and carrying that full effect annualised through for those two savings together, so 1.2 translates into 2.

Chris Manners, Morgan Stanley

Okay, thank you. And I guess the second question was on the underlying growth rate you see in 'growth HSBC'. Obvious, AD ratio of 75% is quite low, I know, for obvious reasons you're cautious at the moment. I know in the past you've said you might like to take that ratio up to more like a 90%. How's your thinking on that, and if we are thinking about loan growth coming out of 'growth HSBC' ex the legacy stuff, what sort of rate do you think we could try and target? Thanks.

Stuart Gulliver

I'm not sure we would want to give a sort of growth rate target, but there are no constraints coming about from the AD ratio at all. So we have not managed the AD ratio down; it's come down actually as funds have flowed into us, so we have huge capacity to grow. If you think about in those terms – $1.2 trillion of deposits and an AD ratio of 74 – we would be comfortable with the AD ratio at 90. So actually where there's growth we will be able to participate in it. And you can see that in Asia Pacific. You can see it in Latin America. You can see it year on year in the Middle East.

So therefore I think the important point is that effectively we're open for business, and very much so. Here in the UK we've grown our share of mortgages; we've grown our share of first-time mortgages. Of the £4 billion fund that we established for providing trade finance to small companies, I think £1.4 billion of it has already been drawn, so there's a whole bunch of growth initiatives that come about because we have a strong balance sheet. That gives us that optionality. It's very important. Last question, James?

James Alexander, M & G Investment Management

Just a question on regulations and regulatory certainty: there's quite a desire in the room and amongst banks for regulatory certainty, but given the way banks operate – and they demonstrated they way they operate last week – the moment they have regulatory certainty there'll be out to arbitrage it and cause all sorts of risk again. So I'm wondering whether this desire for regulatory certainty should just be sort of put in a box, and you should just move on in a way and stop having so many targets about returns on risk-weighted assets and returns on equity and see whatever it comes out as, because you can't get away from constant regulatory uncertainty.

Stuart Gulliver

Can I take a vote of hands on this in the room? I quite like this approach, James, actually, it has to be said. And I think you're right; events of last week are clearly a significant setback for the industry, and that's one of the reasons why it's hard for us to put down a slide that goes where Alastair's thinking is, which is this is a massively capital-generative bank that is operating in the sweetest economies in the world, and therefore surely you'll be in a substantially strong position to pay increased dividends. That's probably true, but when we arrive at that will be part of a function of when does the regulatory environment firm up to an extent where we have certainty as to how much capital we have to retain.

In terms of targets, ROEs, RORWAs etc, if we could get to a situation that you've just described – and perhaps M & G could increase its weighting as a result of this – you know, there's a community at the front of this room that would be really quite welcoming of this approach, but I'm not sure that that necessarily would fit with every single big investor. You know, the fact is what I do agree with you on is we are where we are with this. It will go up. That's why we cannot say, you know, we're going to be returning huge amounts of cash that is surplus, because we've no idea at what point we get to huge amounts of cash that is surplus, not because we don't have visibility on growth in our own business; it's because we don't have the endgame as to how much capital we'll have to hold. And it's as simple as that.

Iain Mackay

Your comments may be very helpful, James, because one of our regulators is sitting in the room, actually, taking notes furiously, I'm sure. But the certainty question is a broader one. It's not just about banks; it's about the investment environment in the broader economy. As a significant provider of credit to those economies, there is some element of certainty which would probably be a good thing for the economy as a whole, don't you think?

Stuart Gulliver

So, just to wrap up, I think there's one slide I just want to put up, hopefully, which is why you should own HSBC. And I'm not going to run through the slide, but look, a year ago, we set out a plan to reshape HSBC, to focus on our natural strengths and to make the Firm easier to control, and we hoped to create a compelling case to own the stock. Today we've confirmed what has been achieved in the year and what remains to be done.

So in closing I'd like to say the following. Now, our industry is undergoing profound change; the economies we serve want banks to change and we kind of get that. And we believe we've made progress and we hope you recognise that, and we also hope that you've got greater confidence now in the management team that we have to change HSBC for the better. Thank you.