Transcript

Post Annual Results 2012

Meeting with Analysts hosted by Iain Mackay, Group Finance Director

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Corporate participants:
Iain Mackay, Group Finance Director
Russell Picot, Group Chief Accounting Officer
Jane Leach, Head of Group Regulatory Reporting
Nick Collier, Head of Group Investor Relations

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Right, good morning everybody and welcome. I'm very pleased to welcome and introduce Iain Mackay, our Group Finance Director, and Russell Picot, who's Group Chief Accounting Officer, and all colleagues. The team do work terribly hard in putting this document and all the information together. What we will do is go straight into Q&A. There will be questions from Hong Kong. This will be recorded and the transcript will be put up on the website, so for the sake of completeness please could you mention your name and organisation before asking a question. So, without further ado, if there's a first question and the mic can be pushed that way.

Raul Sinha, JP Morgan

Can I just probably ask you to start talking about, not the results, but the transaction you announced yesterday? Could you kindly give us what is the risk weighted assets attached to the stuff you sold, how representative that is of the remaining assets that you might decide to sell, and how we should think about the capital impact of that sale?

Iain Mackay, Group Finance Director

This is a slightly different book to the usual: this is non real estate – this is non personal, non-real estate personal lending. So the risk weighting in this is slightly lower, but if you take that book as an average, it's about two and three quarters the nominal value of assets, so the risk weighting on that book is about 275%. Of the bulk that remains, so the 38 billion that remains, that really is the risk weighting. It's between 250 and 275, okay?

Raul Sinha

Right. And the loss that you booked, is that a gross loss or is that a net loss of provisions?

Iain Mackay

That is against the net book value, so that's the net loss, if you like, or gross loss depending on how you define it but it's net of provisions. So what was transferred to held for sale was net of provisions.

Raul Sinha

Right. And on the call you said, Iain, that we should expect the 1.7 billion loss in the US GAAP to be broadly similar to IFRS. It doesn't look like that happened.

Iain Mackay

No, I think the loss that we will record on that transaction is going to be somewhere in the range of USD200 million – slightly over USD200 million, which we actually sold it at about 0.5 of a cent better than we expected.

Russell Picot, Group Chief Accounting Officer

We disclosed in the IFRS document a billion being the difference between IFRS carrying value and year end estimated fair values on the non-real estate and the real estate books, which are US subsidiary classified under US GAAP as held for sale, which is a broader measure, and obviously this is the first of those tranches actually being unloaded into the market.

Raul Sinha

And what is the overall size of the book that you referenced to?

Iain Mackay

So there's USD3.7 billion, which was – well, net was USD3.4 billion sold yesterday and the real estate are in tranches which range between around USD450 and USD700 million and there's three of them, the first of which we'll start marketing in the next couple of weeks, okay?

Russell Picot

The billion relates in aggregate to USD7.5 billion of AFS carrying value.

Iain Mackay

So the numbers that Stuart mentioned on Monday, which was about three and a half and 3.8, is about right.

Yulia di Mambro, Barclays Capital

Given the abundant liquidity in Asia, do you think that growing balances there would mean giving up margin? And, if so, how much would you be prepared to give up in order to deploy capital there?

Iain Mackay

You mean growing deposit balances?

Yulia di Mambro

No, loans; risk-weighted assets.

Iain Mackay

No, I think that's been the question for most of 2012, actually, was, you know, look you've got a particularly competitive position, but the yield and the spread that we've been picking up on lending in Asia Pacific, whether in Hong Kong or whether more widely, has held fairly constant throughout the course of the year. In fact, the second half has been every bit as strong as the first half of 2012, so we have not had to give up margins in Asia to grow the balance sheet. I think, again, there's a little bit of a competitive dynamic there. We have tended to pick up market share in a number of product lines from international banks who perhaps – well, not perhaps; no doubt about it – have not had the liquidity or the capital strength that we enjoy in Asia and therefore we've had the opportunity to be really quite selective in terms of the lending we've done, and therefore with the quality and the pricing of that. So we have not, thus far, and it is certainly not our stated intention, to give up margins to grow the book.

Quite the contrary: I think if you reflect on the operating targets that we've set for our teams around return on risk-weighted assets, the challenge for the team around using the Bank's balance sheet is to improve the efficiency of that capital, and don't let it deteriorate. So this is not grow at all costs; this is grow with good profitable business that's generating a return in risk weighted assets absolutely in the range that we need the businesses to generate which, as we've talked about in the past, across the various businesses and within that, if you like, triangulated return and equity of the business of 12 15%, they need to be generating return risk-weighted assets between 2.1 and 2.7.

Mike Trippitt, Numis

Two or three questions, if possible. One is quite broad brush, but I'm just trying to get a sense of momentum in the overall exit, disposal programme. Obviously, it's been a tremendous performance; I mean, another four kicked off this year. I'm just trying to – I know you can't give a forecast, but what I'm trying to get a sense of is the scale of disposals still to come where the businesses don't fit the five filters. Second area is just on the US anti-money laundering. The sort of mood music at the time in the Q3 IMS was very gloomy. You put another 400 million in, I think, into the provisional or paid. Is that done now?

Could you give a sort of sense of whether that's finished? And also just trying to understand, in the US business, on the underlying basis, where you think costs will go from here?

Iain Mackay

Okay. Well, let me do that in reverse order. The US cost base has to go down in absolute terms. Having sold the cards business, which absorbed or helped cover a fairly significant portion of fixed cost for the infrastructure within North America, having disposed or disposing of tranches of the CML portfolio; having disposed of 195 branches, primarily in upstate New York – the amount of work that needs to be done from a cost perspective in North America remains significant. And Irene and the team have a broad range of elements of work to do around systems infrastructure around the support functions, around the distribution network within the Retail Bank and within the overall footprint. This is because we still have offices spread across the US where the core centre for the bank is New York City, but we still have premises near Chicago, where the old household was built, where we have not an insignificant number of staff supporting the businesses.

So the thrust in the US – we can talk about strategy but it’s actually very tactical now – is growing the Commercial Banking business, which the team has made good strides and good progress on over the last two years, continuing to grow out of New York as the hub for the Americas business, so a lot of the Global Banking and Market client base and transactional support for the Americas as a whole, we run from New York. And getting the cost base, in actual fact, the footprint for the firm aligned to what that bank looks like going forward, which is a relatively small, very premier focused Retail Bank and Wealth Management business, Commercial Banking and Global Banking and Markets. So the cost equation, in relative and absolute terms in the US has to be down. That's the trajectory and that’s got to be maintained. It’s a lot of work; we do not expect this to be accomplished in 2013 and, in fairness to Irene and the team, they have been very clear that this is a two to three-year piece of work, to get the US in the kind of shape that we want it for the future with a cost base, or, if you like, a support capability, aligned to it. That's the US.

As far as anti-money laundering goes, we entered into a DPA, a deferred prosecution agreement, with the Department of Justice and certain other agreements with the OCC, the Federal Reserve, the US Department of Treasury and the FSA on 11 December last year. The fines and penalties we paid. As far as those matters are concerned, the matter is closed, except for we are under a five-year deferred prosecution agreement with the Department of Justice. As we disclosed in the annual report and accounts, a monitor will be appointed. That monitor is a single person who will act – who will probably sit in our premises, whether here or in New York – probably, actually, they will do a fair bit of travelling around the world – and they will assist us and monitor what we are doing in terms of addressing the concerns raised around controls with respect to anti money laundering and sanction. But as far as the fines and penalties go with respect to that matter, we are concluded, okay?

On your last point, the scale of disposals remaining, I think Stuart made some reference to the fact that his view that we were 80 to 85% complete on this front. We will certainly focus a fair bit of energy this year – in fact, our US colleagues will focus a great deal of energy this year – on how we can continue to accelerate the run down in the CML portfolio. But there remain – I think, of the transactions announced, I think there are still about 17 transactions we have to complete, so there’s still a lot of work around ensuring that the transactions have been announced complete both on the timeline that we’ve described as well as under the conditions we’ve described. And there continues to be, I would say, a fairly continuous reassessment of the entire portfolio against the five and six filters that we’ve got.

There are, as I’ve remarked in the past, there are business that – when we first went through the portfolio in the beginning of 2011, there were businesses that we looked at and said, ‘Do you know what? They’re just fine.’ And as we’ve dug in and done more analysis – and then, frankly, how some of the economics have changed and the regulatory environment has changed, with less emphasis on the latter, certainly from a prudential perspective, there are businesses that we thought were a great fit which we’ve concluded is no longer the case. By the same token, there are businesses we thought were not a fit which we’ve equally changed our minds and said, ‘Do you know what? These actually, with a bit of work, can be good businesses but they do require some work.’ And I think in the scale of reshaping the portfolio, we’re 80 to 85% complete and certainly in terms of the big transactions, the ones that have significant value attached to them, I would say we’re probably closer to 95% complete.

Chintan Joshi, Nomura International Plc

The PBT impact of the remaining disposals is now fairly nominal?

Iain Mackay

I think the US impact – you probably missed that, Chintan – the impact that we've got that we've highlighted in the annual report account disposing of those tranches that we've identified for disposal and have been accounted for as such in the US GAAP financials, we've got about a billion that we would expect to take in terms of impact on PBT this year – assuming we can conclude transactions. If we don't, that's upside for PBT plan, but in every other respect downside in our view.

Chintan Joshi

Just on that, I mean, if I look at the HSBC disclosures, your fair value negative has come down quite a bit: 8.7 billion, if I got the number right? So I'm just wondering is this something that's an improving trend? The assumption's going behind this…

Iain Mackay

I think you are reading in the newspapers the same as we are about the US property market. I think possibly sequestration is a slight cloud on the horizon in that regard. We have seen and we've got nauseating amounts of detail in here by state in terms of what we've seen happen in average property prices and the concentration of lending that we've got by state. And overall for the US we have seen progress in property values. That being said, there are a number of states where you actually continue to see property prices decline. But overall, for the portfolio, the picture tends to be improving. Delinquency in a dollar basis is slightly down – I mean, basically flat. The rate is always going to deteriorate because the denominator is shrinking here, which is a good thing, but overall we've seen, in terms of performance in the portfolio, very steady but continuous progress over the course of 2011.

Now, hoping that the US government gets to some resolution on their unfortunate standoff at the moment in reasonably short order, then, you know, our expectation is not that altered in terms of just slow but steady economic recovery in the US, and I think that will reflect through to housing. I think what you're seeing in consumer confidence numbers in the US is good news as well. Again, that's probably going to take a little bit of a dent if sequestration goes on for weeks or months. But, no, the book continues to improve in quality and the main thing, probably, is that it's shrinking, but it is improving in quality.

Chintan Joshi

So I mean on current trends that fair value number should be coming down?

Iain Mackay

Fingers crossed, yes.

Chintan Joshi

I mean, it's gone from being capital neutral to slightly capital accretive. So I just want to make sure that is really the case.

Iain Mackay

Cause for some cautious optimism, I would say.

Chintan Joshi

Just coming back on the question on capital from the conference call yesterday, what activities are these that gave that 50 bps impact between 9.8 and 10.3?

Iain Mackay

Immaterial holdings?

Chintan Joshi

Yes.

Iain Mackay

That is basically – to put it in very blunt terms, it's our Delta One desk. It is equities in banks and other financial institutions and equity derivatives in those same positions and how they are treated from a capital perspective in terms of matching the long and the short positions–. So, in our view, that is a relatively low-risk position. The current interpretation that we understand from the FSA, that the FSA has guided us to, is that as CRD IV is written in that regard, with respect to immaterial holdings in financial institutions, that will be a deduction against capital. To the extent of our holdings, that would represent about a 6 billion deduction against capital.

Through working with Samir and the team, we are very confident that, should that guidance remain in place as CRD IV is finalised, we can mitigate the entire capital deduction impact and in its boldest form we can mitigate it by closing the desk down. Now, that desk has very limited PBT impact for the group, about somewhere between 10 12 million per annum, so in terms of a net loss from an income perspective it's – I should not call it negligible because I don't call anything negligible – but it's not material to the group and we believe that we could unwind those positions in the course of literally a couple of months.

Chintan Joshi

But Delta One would feed into many other divisions into GBM?

Iain Mackay

No, we don't believe so. I mean, Samir – I mean, we also look at interpretation and it is very different to how the US is treating this, for example, very different. So, US banks would not see this deduction. Other British banks, other European banks would, to the extent they've got these activities in their portfolio, which any of the investment banks will, then it's probably quite a significant reduction for them. But we don't know.

Chintan Joshi

And the final one on Asia Pacific. I mean, if I compare to your peers – and hopefully my adjustments of the notable items is correct – I get growth of about 7%, which is much below what some of the peers are doing. I'm just wondering what is happening in that region.

Iain Mackay

I mean, we're not driving growth at all costs. We've got targets out there around return and risk weighted assets which triangulate to return on equity for the group. The teams, particularly in Global Banking and Markets and Commercial Banking, have been told, 'Look, there's balance sheets there to use but you're going to recycle and you're going to drive after more capital-efficient business with a focus on improving return on risk-weighted assets.' So it's not growth without profits coming with it.

Michael Helsby, Bank of America Merrill Lynch

I've got loads of questions, obviously, but I'll just do three if that's alright. Firstly – it's a bit of an odd one actually – given the move in sterling versus the dollar, I was wondering if you could tell us what your sterling revenues and costs and bad debts are for 2012?

Iain Mackay

So I think if you got the annual reports and accounts and look at the global business and look at the UK contribution to profits – which, by the way, in 2012 was nothing – that gives you some sense as to the scale of that business and that's really our sterling business. In terms of – we've got a pretty evenly matched book from a funding perspective there, from a capital perspective. So the expectation from movements in foreign exchange, on the results of the group, is pretty muted, we think.

Michael Helsby

So that's at the PBT level?

Iain Mackay

Yes.

Michael Helsby

Okay. If you do have it from a – sort of the lines, that would be helpful. Is it there?

Russell Picot

We're just trying to get you a set of – our UK bank published results on Monday as well. There's a separate annual report which we're just trying to dig out a set of.

Michael Helsby

Okay, perfect. It's just because that's got all the Europe bit in it as well. Okay, perfect. Thank you.

Iain Mackay

It's on the website as well if you want to pull it down.

Michael Helsby

Thank you. Fair enough. Just listening to what you said on the US costs, I was wondering if you'd be willing to share what you thought that right cost base was – ballpark?

Iain Mackay

So group cost efficiency 48 to 52, right? The cost efficient ratio in the US. We're looking to get into the low 60s. I think the main driver in that is we've got a Retail Banking and Wealth Management business, which is frankly sub-scale. Our focus in the short term – dare I call it the short to medium term – is to get that business to profitability. At the moment, it's losing a couple of hundred million dollars a year, so the US bank business – forget the HSBC Finance company – but the US bank business, Retail Banking and Wealth Management, is losing a couple of hundred million a year and our goal is to get that to profitability within the next couple of years, but it is going to take a couple of years to get it.

And I think we've got the right start, we've got the footprint, from a branch perspective, that we want in the areas of cities that we want, but what we've really got to work on is the cost base, how we serve that platform. It will be very Premier focused, but there's a couple of years' worth of work there to get the Retail Banking and Wealth Management business to a position of profitability in the US. And that's the main driver behind the higher cost-efficiency ratio in the US for the next few years.

Michael Helsby

Okay. Thank you. And finally, just I think on page 51 of your book, you said you were reducing the cost of equity to 10% next year. I was wondering, when you set your target ROE, was that in – I can't remember, is that in reference to cost of equity, or is that just the ROE that you think the business makes?

Iain Mackay

Clearly, I mean it was part of the consideration but it was more in reference to the performance of the businesses that we've got. So I think the page that we popped in here, Michael, is page 15 in the charts, which shows the return on risk-weighted assets within the businesses and clearly across Commercial Banking, Global Banking and Markets and Private Banking, we are sort of in the range that we want to operate at, albeit the lower end of the range in one or two of those businesses. We've work to do in Retail Banking and Wealth Management, and it's a sort of similar story from a regional perspective, but how we develop that target was clear. I mean, you clearly need to be returning above your cost of equity, so it wasn't the driver of the calculation, but it was an important input to it, clearly, that if the portfolios weren't generating a return on equity that we could see, on an ongoing basis, that was somewhat in excess of our return on equity, then we kind of didn't really have a proposition here.

What we've done over the course of the latter half of last year was clear a lot of analysis with respect to what we think the cost of equity is but also engaged with some of our major shareholders and really got some input from them as to what they saw in the industry as a whole in terms of trends of costs of equity. And, as a consequence really of our own analysis and then some consultation with the investor community, we concluded that it was an appropriate change that we'd made for 2013.

Tom Rayner, Exane BNP Paribas

I mean just following on, I think, from the question I asked you on the conference call, actually. I mean, slide 8 you've given us a continuing business basis but not maybe fully adjusted. I'm just sort of interested in pursuing the revenue a little bit more because I think, if you adjust the 63.5 for notable items, it doesn't change huge amount but it looks like growth of maybe 8%, adjusted for currencies and all notables as well. I'm just trying to get a feeling – if we looked at this slide 12 months on and we're looking at the 2012 base, how much is that likely to adjust, do you think, for further disposals and sales which are sort of part of the ongoing process? I'm trying to get a sense of where that base comes down to, to then think about what the underlying growth can be on that? Is there anything you could add to that?

Iain Mackay

I mean, I can't remember if we put it in the appendix but there is in the annual – yes, we did put it in the appendix: on slide 30 there is the list of all the transactions that we have announced and we've marked those which are completed and those which are not. If you just do a cross reference to those businesses that are still included in this number and reflect on – I mean, if you look at the regional breakdown, it will give you some sense as to what may still have to come out of this number. But when you think about it, it is really the Latin American businesses which are not material contributors so, outside Argentina, Mexico and Brazil, Latin American business were not and have never been material contributors to profit before tax and returns for the group. So, in terms of transactions announced which have not yet closed and therefore are not stripped out from an underlying perspective here, there's very little, it's actually Panama, and that's about it, and that was about just over a hundred million in PBT, right? So there's not much impact to come out, either in terms of revenue or, frankly, costs.

Russell Picot

So, Tom, the underlying revenue number is a very clean number because it removes the impact of all disposals, including contribution to current year financial performance.

Tom Rayner

I guess I am also trying to get a feel for how close to the end of the disposal process are we? Because I think even yesterday there was another one announced and probably people do their numbers again already.

Iain Mackay

Sorry, you missed the earlier couple of questions, Tom. We reckon we're about, as Stuart mentioned in the call, probably 80 85% through from a numbers perspective. I think in terms of value, certainly based on what we've got on slide 30 in here, an impact on revenues costs, PBT, we're more than 90% of the way through, based on what we've announced and frankly what we might announce. So, as Russell said, the revenue number is, I think, a pretty clean number.

Manus Costello, Autonomous Research LLP

I had a couple of questions on risk weighted assets – one specific and one general. Russell, thank you for the additional detail on risk weighted asset flow, putting the EDTF principles into action. I noticed there was quite a big move down in the US on an organic basis as the riskiness of those assets came down and I just wondered, given your comments about the housing market generally, how much scope you think there could be over the next couple of years for that average risk weighting in the US to fall? So we see a fall in RWAs, even excluding any asset sales which might be yet to come. And then, secondly, just more generally, on the call yesterday, Stuart talked about sort of indicating 7% being the kind of underlying revenue growth level to expect for this year in response to Tom's question, I guess. Should we be thinking about that kind of high single-digit RWA growth on an underlying basis for the next couple of years as well?

Iain Mackay

First question, the RWAs: what will move RWAs in the US now is disposals and the run-off the CML portfolio. So I think from a – this is IRB advanced model; it's modelled on downturn PD, downturn LGD, so what's going to move that is elimination of exposure at default.

Manus Costello

Presumably, also improvement in loss given default if…?

Iain Mackay

That will help, but I think the scope from a loss given default perspective, is downturn as well.

Russell Picot

Yes, that's on a stressed basis, so when you hit the bottom, even when you recover –

Iain Mackay

It doesn't come back.

Russell Picot

The model still calibrates on downturn stressed LGD. So if the PDs improve that, over time, feeds in.

Manus Costello

And the USD18 billion improvement this year, then?

Jane Leach, Head of Group Regulatory Reporting

So there's a couple of factors there which are covered in the paragraphs following in the Annual Report and Accounts. Essentially, part of that is a recalibration of that model during the year. So where there's a recalibration with more recent data that has caused some improvement. Some of it is simply run-off of poor performing assets and some of it, actually, is that there is some movement into default, and that actually causes expected loss to go up and RWA to go down. That's a part of that, as well as then some improvement in the remaining book, which caused risk weighted assets to go down in that remaining book. So it's quite a complicated picture in total for that USD18 billion reduction.

Manus Costello

Okay. Thanks. And on the on-going growth for the Group as a whole?

Iain Mackay

Revenue or RWA? What was the question, sorry?

Manus Costello

RWA. Should RWA and revenue be kind of in that 7 8% range?

Iain Mackay

I wouldn't – there are so many factors, as Jane just pointed out, there are so many factors impacting RWA around whether it's in a standardised approach, whether it's in an internal ratings based approach, the rate at which we can get models approved by the regulator, changes to some of the inputs to those models by supervisors around the world. There's been a fair bit written about a recent change in Hong Kong as it's related to residential mortgage and new business, for example. And the other aspect, again, is just the efficient use of our capital from a business perspective where we are very much challenging, particularly the Commercial Banking and Global Banking and Markets teams, to get more efficient. So I wouldn't necessary view revenue growth and risk weighted asset growth as being that tightly correlated. There's clearly a correlation but I wouldn't – you know, the R2 in that is probably weaker than you would expect.

I think from a revenue growth perspective, we see good opportunities for growth – it continues to be the case in Hong Kong, it continues to be the case in the rest of Asia Pacific. I think Brazil has bottomed out but I think the economic recovery in Brazil is probably fairly muted. Mexico's looking really quite stable and reasonably good. I would say that in the majority of our markets outside the European Economic Area, the growth outlook is reasonably sound, and we are reasonably well positioned in those markets, as was the case in 2012, to build on some of that. I think we're reasonably optimistic from a revenue outlook standpoint for 2013, based on the conditions we're looking at today. We've certainly had a good January and February. There's cause for cautious optimism here, from a revenue perspective.

Manus Costello

To be honest, it's not so much the revenue, is the capital side that I'm interested in, because I'm trying to get to this – there were a lot of questions yesterday around dividend pay-out ratio and where you get to eventually, and I'm trying to get to what you think, given the exposures you've got, to coin a phrase, the underlying metabolic rate of RWAs would be in those regions if I think about the mix of your business. Because we're obviously plugging in an ROE and dividend pay-out ratio, what do we think we need to retain to fund that risk weighted asset growth? I would assume somewhere in the mid to high single digits, given your exposures, would be reasonable on an underlying basis. I wondered if that was a reasonable assumption.

Iain Mackay

Well, I think there's two things you'll see coming though RWAs this year: you're going to see a lot of reg change coming through so the numbers – well, that's a good point, it may actually not be until 2014 now – but in theory we'd have seen it coming in 2013 with CRD IV, but it's probably not until 14 now. But, certainly from a planning perspective, we'd factored in CRD IV to take effect in 13, but on top of that we've got more than sufficient capital within the legal entities in Asia Pacific, Latin America, and the Middle East, to support the growth that we want to be able to drive and we've got, we believe, more than sufficient capital to fund that growth.

And clearly we've got an objective here of redeploying that capital profitably but, as Stuart said on Monday, we need a little bit of time to work on that and if we find that we're unable to redeploy that profitably, then we'll reconsider what we're doing from a return to shareholders perspective. But we've clearly generated a lot of capital from disposals and from profitability this year; we've got market opportunities to reinvest that capital but it cannot be done overnight – at least, it can't be done responsibly overnight, so there's a bit of time to work on that front. That is the goal but, by the same token, as Stuart said, if we find that over the course of the next 18 24 months that that, given the scale of what we think we've got in terms of capital capacity, if that cannot be redeployed, then we clearly need to revisit, in a pretty serious fashion, dividend pay-out ratios or other alternatives.

Ian Gordon, Investec Securities UK

Just following on from Manus' question, I don't really give a monkey's about the RWAs; all I care about is the revenues, because –

Iain Mackay

I would never have guessed, Ian, based on how you write us up, yes.

Ian Gordon

Joking apart, I'm very encouraged to hear you talk about the good January and February, but you've already told us that you're not planning to be aggressive on margin in order to drive growth. On a constant currency basis, loan and growth was muted in 2012, although there were some – I thought – encouraging signs of pick up in Hong Kong and the rest of Asia Pacific, so just in terms of incremental progress, other than just the sort of broad guidance towards the emerging markets, are there some more specific pockets of accelerating growth that you can draw our attention to?

Iain Mackay

If you look at that – and as Russell said earlier, that underlying revenue number of 7% growth is a very clean number. When you then look at how we broke that out on the P&L, it was in every single line of revenue: it was net interest income; it was trading income; it was fee income. The Wealth Management business in Hong Kong and, really, broadly across Asia Pacific, grew very nicely in 2012 and we expect that to continue in 2013. The reinvestment that we're putting into our mainland Chinese business, where we've been given through the CEPA agreement in Guangdong province, the ability to grow, to build out that network by more than 30 branches this year is absolutely – you know, it's never been heard of. I mean, we've been able to open somewhere between five, six, seven, eight, nine, 10 branches per year in mainland China and the ability to build out 30, in the most important province for us, is a very significant step forward. We've now got a Retail Banking and Wealth Management business in mainland China that is profitable. Continuing to build the profitability in that business is, we think, very achievable – continuing to build the CMB business and the Global Banking and Markets business in China very profitably continues to the the case.

That's equally the case in Singapore. We've made good process in India; India's a bit of a challenge from a reg standpoint, as we all know, but the opportunities for the team in India continue to be very positive. Equally the case in Mexico.

Interestingly – this one will probably bamboozle you a little bit, but we like the UK business a great deal. It's a good business on the revenue line. The fact that we're disgorging all our profits plus back to customers, existing and former, is more than a little bit worrying. But the underlying business, from a Retail Banking and Wealth Management and CMB perspective, are high return businesses – not unreasonably high. You know, you'll look at it and go, 'Right, let's go back and adjust all the redress from prior periods, look at the returns on that and then say, 'Were you really making ridiculous returns?' The answer is no: they're in the range of 12 15% from a return on equity perspective. So we like the UK business: we've grown our market share in mortgages; we're still just over 6% on stock and slightly over 12% on new flow this year. It's a customer base that is our customer base; they're our deposit account holders or current account holders or credit card holders, so that's a business we like to grow. We've grown our SME business this year, put with a very strong focus on international, you know, exporters/importers, which has gone really well. We like the quality of that book, so the UK we like.

Germany we like but that's a bit of a tougher pool because it is very much focused on international SME and large corporates, and frankly there's muted appetite at the moment, based on some of the uncertainties – not so much within the Eurozone, but just trying to get a sense as to whether the US economy continues to click along and whether Asia can continue, driven by China, to hold up reasonably good rates of growth. I think the rates of growth we've got in China is about 7.8 7.9% for this year, and for the wider Asia I think it's about 5.4 5.5%. So I think the Asian markets we like, Mexico we like, Brazil we like – but it's going to be a little bit muted again in 13 as it was in 12, but it's still going to grow. The Canadian business is doing well: we've been over a billion in profits there, the revenues have continued to grow and I think again, although it's not going to contribute the lion's share of it, we'll get good CMB growth in that market, as we will in the US. So there are literally a dozen substantial markets for us where we've seen revenue growth in 12 and we fully expect to see that revenue growth in 13. So I think that 7% is a very clean number and we're clearly focused on trying to accomplish something like that or better again this year.

Ian Gordon

Thank you, that's very helpful, though just one quick follow up. I mean, I guess you have spoon-fed us a bit with the numbers: you've given the underlying cost efficiency ratings. You've given us a good line of sight on where the 'E' goes and, if I were to take a more positive, aspirational view on some of those revenue dynamics, I might get ROE to 12% by 2015 and I might get cost efficiency ratio to 52% by 2015. 2013 isn't on the table and so I just don't understand why you'd leave it there.

Iain Mackay

There's a very simple reason why we leave it there. There's an aspect of building cohesion around 260,000 employees, about things we need to do to reengineer this firm. We've done – you can do a great deal, as we have done, about changing the portfolio and you don't need 260,000 people to do that; we need about 20, right, and they've all worked really hard for two years and, along with the business teams, have done a great job and continue to. I mean, the transition agreements around some of these larger disposals are very complex and the teams have done a great job and continue to.

To change how the firm works, from an efficiency perspective, in interaction with customers, you need a much, much greater proportion of the 260,000 and there is aspects of having very clear, well established goals out there to help guide and drive some of that behaviour. So we talked around the pipeline of sustainable saves that we've got for 2013 and so just simply the monthly operating rhythm around what we do around what we do on cost management is getting better, but we've got to do more and continue to improve that. On building the pipeline and then delivering against those projects, the teams have done a good job but there's more to do, and part of keeping those targets in place is just keeping that constancy around it.

We recognise, absolutely, that the 48 52 is very very difficult to achieve, dare one say, impossible, in the timeline that we've set out. When you get to underlying it's about 56%, right? But that's four percentage points away and that's a lot to do, and unless we get a miraculous increase rate increase in 2013, it's probably not there. We're giving a great deal of thought about – that was a three year target we set and the reason we keep it is because it was a three year target we set. We're giving a lot of thought as to whether what we should be doing in terms of – not a three year target but a much longer – you know, if you can look five/ten years into the future, what – based on regulatory change, structural change coming from Vickers, for example – what should the long-term sort of cost-efficiency ratio for the firm look like? And, you know, we're doing a lot of work around that; we've done a lot, we'll be doing more and if we think it merits a change we'll talk about it in May at the Investor update.

From an ROE perspective, our targets were very much set on an expectation of what we needed to do from a capital perspective under a Basel II.5, a transitional Basel III and a fully-loaded Basel III. When you look at the underlying performance of the businesses, we can see 12-15%. You clearly see 12 15% return on equity. We, equally, clearly see that we've got drag from legacy credit, we've got drag from CML and we've got to sort out the UK – but those are all things that we have progressed over the last two years, will continue to progress over the coming years, but I wouldn't even try and even if I did I couldn't persuade Stuart or anybody else away from 12 15 because we see it in the core of our business. So, you know, the targets are tough but if they were easy there wouldn't really be any point setting them.

John Caparusso, Standard Chartered

Hi Iain; thanks for taking my question. I have a question around growth related to transaction banking, so PCM and the trade business. I see that the revenue growth for last year was 11% – obviously it was a bad year for trade so it's a little bit down over the previous year. I just want to get a sense of a couple of things: first of all, what do you see as being kind of the run rate potential of that business? I guess, secondly, on that business, it looks like it generates around 15% of group revenues at this point and so, given the amount of emphasis and a lot of the discussions around the strategy on, you know, trade as being so central to the Group's strategy, I would have thought it would be kind of higher. So I'm assuming that there's a lot of revenues that are really linked to trade, receivables and transaction banking in general and if you could provide a sense of that, that would be extremely useful. And I guess finally there's been some discussion last year about potentially increasing disclosure on this business, potentially down to the line of pre-tax so I'm wondering if I'm missing something or whether we might look forward to that, going forward?

Iain Mackay

So from a trade bank perspective or PCM and Global Trade and Receivables Financing, that according to Oliver Wyman is now – I think we sit at about 11% market share globally. That business, both PCM and GTRF, grew very successfully in 2013 in what you rightly described as fairly difficult trading conditions. Part of that was – in fact, a significant part of that growth was taken through capturing market share through some of our competitors. That trend continues in the latter part of 2012 and into 2013. The capabilities that we've invested in, both in terms of product and technology, and people, in effect in the last two years there's a new leadership team in place within the PCM trade area and I think the regional teams that we've got in place around the world are incredibly well connected – much more so than was the case, for example, two years ago or even a year ago. And the growth opportunity in that business continues to be very much the focus for Alan Keir and his colleagues in Commercial Banking – but not only in Commercial Banking, but supporting some of the larger corporates through Global Banking and Markets, and increased collaboration revenues between CMB and Global Banking and Markets.

So, you know, I think with the 11 13% growth in that area in 2012, I think we've got a pretty good platform to continue to grow that business into 2013. Again, the trading conditions will be a not insignificant determinant in how successful that growth is, but the platform that we've got in place and the team on that platform are extremely capable and very focussed around capturing some of that growth. So I think we're reasonably confident and robust with respect to that.

In terms of giving you a full P&L on PCM and trade, don't hold your breath on that one; we probably will give you more line of sight on the revenues, and it's one of the things that we're working on, within each of the global businesses, is to give you a little more line of sight on revenues as we do in Global Banking in Markets. But to give you a full P&L on each of these product lines – I don't think so.

John Caparusso

I was just wondering about that because, you know, on other banks that do disclose it looks like the return on risk weighted assets is around roughly twice the bank average and I can only assume that that's probably true for HSBC as well. So that would take the contribution to the bank to 25% of bank profits or so and does that seem wildly out of the ballpark to you?

Iain Mackay

I haven't done that math, to be perfectly honest, so I'd probably best not to comment. But what I will say is the return – you know, a lot of the revenue stream in that business is fee-based; it doesn't use much of our balance sheet – in fact, it uses virtually none of our balance sheet. The risk weighted assets against the PCM and Global Trade Receivables Finance business is a very small number.

Russell Picot

I mean, that business obviously also picks up operational risk risk weighted assets, but it tends to be a lower RWA density activity than straight lending would be.

John Caparusso

Yes, clearly, hence the attractiveness of the question. The third question, I guess, was about, you know, is there a lot of ancillary revenue that's linked to trade which is not included in the 15% of group revenues that I'm seeing here?

Iain Mackay

Foreign exchange.

John Caparusso

Yeah, okay. And I don't know if you could provide this, but roughly what portion of your forex do you think is trade linked?

Iain Mackay

I don't know that.

John Caparusso

Okay. Thank you very much.

Iain Mackay

You’re welcome. Next question.

Jason Napier, Deutsche Bank

I have three on regulation, I'm afraid. Last week JP Morgan gave an estimate of what they thought post-trade clearing and those sorts of issues were going to cost them at 10% of FICC revenues. Given that FICC is not mammoth within the Group, I wondered whether you would hazard an estimate of your own.

Iain Mackay

That’s an easy answer: no.

Jason Napier

Second question: does 10% sound like a crazy kind of haircut, or is it just too early to – any idea?

Iain Mackay

I don't know. And Jane, who is buried in this stuff, is shaking her head so the answer’s definitely no.

Russell Picot

Three noes I’m afraid, Jason. You’re not through to the next round.

Iain Mackay

Moving on from regulation.

Jason Napier

Second question then, you highlighted sort of how Vickers features in the medium term, the five ten year horizon. What are you saying to shareholders at the moment in terms of impact on the Group in terms of cost?

Iain Mackay

Impossible – I mean, there is a cost, right? But what Vickers looks like, other than there's a ring-fence somewhere, and it's somewhere around retail banking operations – whatever that might be described as – but let's assume it's the retail bank and the commercial bank in the majority, what's inside that? Can we do interest rate hedging? Can we do foreign exchange hedging? Which, if we can't – I mean, I don't know how you can put a retail bank around it without being able to provide those services to your customers – but where the ring-fence is, what's in, what's out, how it's going to be – I mean, we've got some guidance around how it might be capitalised.

But it is – I mean, we spent a huge amount of time, not in 12 but in 11, thinking about this and we drove the UK team nuts building models and after having built numerous models we said, 'You know what, this is a complete waste of time until there's some clarity around where that fence might be built.' I mean, in terms of preparation to be able to respond to, you know, the Finance Bill, we've provided hundreds of hours of work to responding to questions and trying to guide that dialogue, but what it really means for us – either in terms of cost of implementation or cost of funding, and let's assume that would be mostly on something that wasn't ring-fenced, you know – how much so-called bail in would you need around a wholesale bank? What sort of rating would you need? What sort of capital would you need to have to be able to attract a reasonably robust rating, having a direct knock-on impact to your cost of funds?

I mean, we kind of throw out numbers in around hundreds of millions of cost to implement and cost to fund, but when does that kick in? Again, one of the things that we've encouraged very actively is 'let's get on with it'. You know, messing around with this in 2019 isn't going to help anybody. The piece of legislation that Karine Berger put in front of the Assemblée in Paris, which seems to be roaring through at a ferocious rate, and they're hell-bent on getting this implemented in 2014 – that sounds pretty sensible stuff to us. The Germans seemed to have jumped on it, which is probably because it's a pretty nice piece of legislation from a banker's perspective. But we're just – we're, you know – impossible to say really, Jason. I wish we could but it's impossible to say.

Jason Napier

No, I think that's a good answer. But would it be a decent summary to say, you know, if it's hundreds of millions on funding and implementation, it's something that's coming but it doesn't actually change your view of the strategic shape of the firm? It's just an operating cost.

Iain Mackay

So I think this probably isn't a terribly popular view, when we discuss this in the various forums that consult on this matter with government. The way we view the UK is the same as we view every other business in the Group. It is one of our home markets and it's a really important market. We like being in London. As I mentioned earlier, the Retail Banking and Wealth Management and Commercial Banking business here have good returns in them with a good customer base, but if we get to the point where we can't generate a return above our cost of equity in the UK, for whatever reason – whether it's because we spend our lives disgorging profits to the customers because they don't get good outcomes, whatever the hell a good outcome means – it's an investment. We've got a portfolio of businesses that we're very focused on growing and managing in a disciplined, customer focused and, dare I say it, regulatory focused manner. But it would be really nice to have the balance focused on the customer and the returns for the shareholder but we've got a fine balance to strike and we will do that.

But the UK is the same as any other business. I don't think we will get to this point, by the way, but were we are unfortunate enough to get to the point that we simply couldn't generate returns from running the business well in the UK, for whatever reason, then we'd have to sit and revisit the amount of capital that we've got invested here. But I think where we sit at the moment is: it's a great market; it's a great customer base; regulation is not at the level today that would drag us in that direction of saying we can't make the return; and we're hopeful that, whether it's structural or whether it's capital structure or whether it's conduct, that we don't get to that point, and I think we play an important role in ensuring that we don't get to that point.

There's a lot of things that we have done and will continue to do to improve how we interact with customers, the clarity and the quality of that interaction, but I think it has to be defined at a certain point, that – I don't think caveat emptor can be abandoned and at times at the moment it feels as if it possible has. But we just need to keep working through this and I think we'll get to a sensible place. What we'd like is to get to that sensible place as an industry as a whole much sooner than 2019 or some point thereafter.

Jason Napier

Okay then. The last one, briefly. I just wanted your view on whether you think the – looks like imminent curbs on bonuses within the industry and Europe actually means anything for the firm or for the competitiveness of finance in general?

Iain Mackay

I don't know. It's a politically charged topic. We really – and I'm sure people are somewhat skeptical of this answer, but we really haven't spent time thinking about this. You know, it came out, what, a week ago? When there's a set of regulation with some detail round it, we'll sink our teeth into it and see what impact it has but the – when you think of the number of people in the firm who that impacts, it's a relatively small proportion. Our main concern is ensuring that, on a global basis, we can remain competitive, and therefore there is a discussion that we'll have with our shareholders about what it requires us to do to remain competitive across that network of businesses that we've got in some 80 countries around the world. But it's far too early to get worked up about this, I think.

Frederik Thomasen, Goldman Sachs

I'm interested in the NII sensitivity to rates that you disclose deep in the annual report, I think it's page 223 if I'm not mistaken. Now, three specific issues that it would be great to get some colour on. The first is that your income sensitivity to rate movements is down, year on year, even though your excess liquidity position I guess is rising, so that's slightly counter-intuitive.

The second one is that your rate sensitivity increasingly seems to be skewed to the sterling block, even though, I guess, the majority of your excess liquidity sits in dollar-linked rates – so I guess specifically Hong Kong dollars as I understand it. And then, just finally, given that rate sensitivity to the sterling, how concerned are you that we might see another rate cut in the UK, I guess either under the current leadership or potentially under the new one in July?

Iain Mackay

Can't really comment on your last point, Fred. It clearly would be a little bit – it wouldn't be good for us, if there were another rate cut in sterling. It wouldn't be good for us if there were a rate cut in any currency in which we operate. By the same token, nor are we necessarily operating under the assumption that rates simply can't go any lower because they obviously could. So the answer to the last point of your question is we hope it doesn't happen – but, as to whether it will or won't, your guess is as good as mine. I don't think it will. Mr Tucker's comments in front of the Parliamentary Commission on Banking Standards were sort of quite interesting but, as you probably noticed, Paul caveated them from here to kingdom come and back again.

In terms of the sterling block sensitivity, I think it's purely a function of the size of the deposit base that's sitting in the UK and nothing more than that because the sterling block is basically the UK and that is it.

Russell Picot

There's going to be some – Fred, there's going to be a bit of currency noise in those numbers because, don't forget, those are translated sterling numbers into dollars as well.

Andrew Coombs, Citi Investment Research, Europe

Just a couple of questions on NII. The first one got raised in the conference call and I just wanted to tie that in with your previous comments on trade finance and cash management, but that's the NII in the rest of Asia Pacific. If you look at the Commercial Bank, it's broadly flat half and half. GBM is actually down a hundred million, and that's despite double digit annualised loan growth, so would be interesting to know your thoughts on why that is and does that relate to compression in spreads on the trade finance and cash management side, in your view? The second question on NII, I'm afraid a regulation question actually, but given the 15% floor coming in or being instituted in Hong Kong, how do you think the industry will react in that in terms of pricing?

Iain Mackay

I think on the Hong Kong point – so that's new business only, right? I think, actually, from a regulatory perspective, it's a, yet again, an indication of fairly sensible macroprudential policy being implemented by the HKMA. They've done a great deal over the last three years to, in some respects, try and take the heat out of the residential property market and, where they were unable to take the heat out of it, ensure that the right capacity to absorb any shocks are there. I think in terms of the market's reaction to that, it will re price over time.

The market is actually very sensitive and very reactive to – and has been trained to be quite sensitive and reactive to regulatory change within Hong Kong. So I think you'll see re-pricing kick in, really, almost from day one in the Hong Kong market. But the impact will be very muted initially. For that to apply to our stock would take somewhere between five and seven years, but I think the Hong Kong team's view is that it's a) pretty sensible, and b) will be reflected in re-pricing. Now, what was your first question again, sorry, on GBM?

Andrew Coombs

Just on the rest of Asia Pacific, if you look at the NII, it's flat in the Commercial Bank and it's down in GBM and that's despite very good loan growth. So I was just trying to tie that into your previous comments about it being a tough environment for cash management and trade finance and wondering if that's a reflection on the spreads there.

Iain Mackay

It's a good question, actually. I don't know the answer to that. There's nothing specifically that springs to mind in either of GBM or CMB. I mean, one of the things that we do experience in those two businesses and the rest of Asia Pacific is the impact of our associates. So, generally speaking, BoCom, in particular, tends to have a dilutive effect on our returns and generally speaking their net interest margins tend to come under a fair bit of pressure. So that may be – and I'm being a little bit speculative here but we can check it – but that may be what you're seeing in the rest of Asia Pacific because, particularly in Singapore, we've seen things hold up reasonably well. We've actually got a split on that, haven't we? Yes, so it is mainland China that we're seeing it coming through and it's a little bit of trade related lending balances with a bit of deposit spread compression, but that's about it.

Chintan Joshi

Just a quick one. In the UK you have an SVR that's below most of your competitors and interest rates have been falling quite swiftly over the past six months. Have you seen a pickup in kind of remortgaging activity flowing towards your way, given that you're pretty much at the bottom end of the offering in mortgages?

Iain Mackay

What do you mean by the bottom end of the range from mortgages?

Chintan Joshi

You are offering rates that are kind of 3%-ish, your SVR is 3.69. Your competitors are more like 3.6 in offerings, 3.5 3.6. And there are products in First Direct that are under 3 – something like 2.8 if I remember correctly.

Iain Mackay

Yeah, that tends to be the offset product, I think, that does that, which is a particularly useful construct which lots of customers like. Again, a bit of a function around rates in terms of where this goes but I think, from our standpoint, the margins that we're picking up on the UK mortgage business are acceptable margins. I mean, that's a business that continues to generate good return for us. The pricing is obviously pretty sensitive and has become even more so with one or two of the banks playing quite significantly – using FLS to be more competitive in the mortgage space, which is what we knew that was going to happen, so there hasn't been that flow through to the SME sector – which was really what was hoped for – but there's been more of an impact on the mortgage lending, which, again, was exactly what we expected to because they were going to get greater relief from a liquidity perspective through mortgage assets than they were through SME assets. I think from a pricing perspective, again, the focus is on trying to remain fairly competitive without having an adverse effect from a margin standpoint. Cost of funding for us in the UK is extremely low; we're not out there competing aggressively for deposits because we've got a fairly robust, you know, core funding ratio but also just a basic ADR ratio. We're pretty happy with it.

Fahed Kunwar, Redburn Partners

I have a question on capital and in China in particular. So you're talking about building out 30 branches in Guangdong, which seems quite a lot, but you're obviously releasing a lot of capital in China as well, you're generating a lot of capital in China as well. I mean, how much capital is there in China, if you include the associates as well? And then, I mean, do you have enough scope in retrospect to grow in China so that you can utilise that capital? And, if not, do the regulators allow you to release that capital from China?

Iain Mackay

The answer to your second question is yes: we don't have trapped capital in China. From a statutory perspective we're well capitalised, I wouldn't say we're over capitalised at all. The proceeds from the sales of the Ping An stakes was never sitting in China, it sits in Hong Kong and the holding company at a parent level. USD19 billion. Right. No, I think – you know the business again, from a growth propensity standpoint, there's – it's got more to do with regulation and the market as opposed to any capital constraints that we've got there.

Fahed Kunwar

Another quick question on PPI. Just obviously there's been industry wide an increase in PPI provisions in the fourth quarter. Just to get an idea of like the run rate for the last couple of months, a couple of the banks are talking about a decrease in the run rate. Obviously I think one year period. There was a story that they'd pulled out of discussions with the FSA to kind of have a deadline on PPI claims. Are you seeing a similar kind of tick down in the claim rate or are you seeing a kind of general level increase?

Iain Mackay

Very steady. I think what we've seen in terms of incoming claims and the composition of those incoming claims has been very steady for the last three or four months. I mean, you see ups and downs but we generally were expecting to see ups and downs. We saw a dip during the summer vacation period; we saw a little bit of a dip coming up to Christmas. But it's been very steady with a, I would say, a very gradual – but very gradual – downward trend on that. So, I mean again – well, you saw what we did in the fourth quarter from a reserving perspective. There was, I think, some discussion around trying to get a cut-off date around it but it hasn't really gone anywhere.

Fahed Kunwar

Perfect. Thank you.

Iain Mackay

I mean, one of the things that we – based on the trend that we've got and our uphold rate, we believe we're sitting on 15 months' worth of coverage and we've got some expectation around seeing that tail-off in claims rate, filter through as the year progresses. But we don't expect to see any cliff effect coming through on this thing; I think there's just a long tail in this which is going to take a long time to run off.

Raul Sinha

Just a quick one. On Hong Kong, I just wanted to get your outlook on the PBT line. You made roughly more PBT than Standard Chartered in Hong Kong last year and the return on equity looks like 55% on my numbers now.

Iain Mackay

55%? Oh, in Hong Kong… Well, I was about to say for HBAP as a whole, which brings it in in the region, it's about 22%, it's…

Raul Sinha

But the RoRWA would be about seven?

Iain Mackay

Yes, that's right, yes.

Raul Sinha

So, coming back to your earlier comment, first of all I guess there are a few adjustments we need to make going forward. What do you think of the outlook for this business? Can this continue to grow at this rate? Because I notice your growth has been very strong recently. And what can you guide us in terms of pipeline?

Iain Mackay

The rate of growth in Hong Kong is linked – one might not say explicitly – but most definitely implicitly to the rate of growth in mainland China, and Hong Kong responds to changes in outlook much more quickly than anywhere else in the region. So if they think things – the degree of interconnectivity, you can talk to businessmen that have been customers for decades of the bank in Hong Kong and they have a view on what's gone on in China and if they have a view that things are going to slow down, they hit the brakes like you wouldn't believe – as if they were heading for a cement wall. So it is very, very much driven by the sentiment around what's going on in mainland China and they respond much more quickly than anybody else. And they usually over-respond, so I think it was in the third or fourth quarter of last year, you saw the growth in Hong Kong go to 0.4% and you saw China still kicking along at about 7.4-7.5% growth.

But the outlook – principally driven around some of the change from a political perspective – was by Hong Kong standards pretty gloomy. I mean, by British standards, they'd be doing cartwheels in the street but by Hong Kong standards they were pretty gloomy. And you saw that come through the amount of trade – the slowdown in trade and lending that was going on in Hong Kong literally from one week to the next. But is very closely correlated to the Hong Kong Chinese outlook as to what's going to happen in mainland China. And I think as mainland China continues to move along and that has a reasonably positive effect on the region as a whole, then you'll continue to see growth in Hong Kong. It is the gateway for trade with mainland China and so the fortunes go. So China goes, I would say, so Hong Kong goes.

Tom Rayner

I noticed you still put the geographic breakdown well towards the front of the presentation, so I was just sort of looking at North America and obviously that underlying -1.5, you've got all of the run-off portfolios and the businesses to be sold. I'm just trying to get a sense what you think North America – because I mean Canada's making a billion –

Iain Mackay

Remember in there the fines and penalties of USD1.5 and a half billion is in there; there's USD375 million booked in the holding company which is in Europe. But there's USD1.5 billion of fines and penalties in that number.

Tom Rayner

So I'm just trying to get a sense of what Canada plus US CMB, plus your sort of restructured Retail Bank ex all the run-off, so what you think North America on a really clean basis is capable of doing and what sort of year are we going to be looking at that? I'm not really asking you for a forecast or anything like that.

Iain Mackay

Canada was over a billion PBT this year, right, and pretty good prospects, continued growth; we've got a good sized commercial real estate portfolio there which we watch very closely and always have. But the Canadian business is just clicking along quite nicely and over a billion in PBT for the first time this year. The US business – so we've talked about Retail Banking and Wealth Management, that's a drag of a couple of hundred million so I'm excluding everything in the Finance company, right –

Tom Rayner

You've said that can go back to profitability?

Iain Mackay

– which we shouldn't because that's going to be there for a while, notwithstanding an expectation of continued gradual performance improvement in the portfolio. But I think, you know, in North America you're looking for a CMB business that will continue to grow, a Global Banking and Markets business which has had a lot of volatility in the past, but in terms of getting the legacy credit portfolios that were quite material in driving that volatility – there's been great progress made. I don't think we've got any leveraged super senior sitting in that book of business now and, you know, it's very, very round numbers but to see North America – not next year, probably not the year after – but hopefully be in a position, excluding the Finance company, to make a couple of billion dollars would be reasonable set of expectations for us.

Tom Rayner

Okay. Thank you for that.

Iain Mackay

Michael, last question for the day.

Michael Helsby

So I'm just staying on the sterling point. I'll follow up with Russell on the other bit later, but page 493 of your book. You talk about your shareholders' equity exposure to sterling and euro for a 5% move. Should I just half that number to get the relative sensitivity, give or take? Or is it slightly more than half?

Iain Mackay

To sterling specifically?

Russell Picot

Michael, if you look at the structural cut above it, effectively what you're doing is you're just applying stressed rates to those gross structural positions, broadly the sterling in euro positions, you use that and then a little bit of maths you'll get a shape of what it looks like.

Michael Helsby

Okay. And finally just on costs because you talked quite a lot about the underlying revenue picture, which is all very encouraging. I think at the Q3 stage, Stuart talked about a sort of underlying cost growth of about 4% and I know Russell's raising his eyebrows now but he did actually say that. And that was once you've grossed-up for the cost savings that clearly you're booking throughout the year. I think for 2012, actually, that number was more like 7.7%, so I was wondering what happened in 2012? Were you disappointed with the cost performance, on a sort of underlying, underlying, underlying basis?

Iain Mackay

The things about which I was very happy in 2012 was the momentum we built around sustainable saves, which we see coming through the financials. The things I was happy about in terms of investment in businesses, whether it was around compliance and regulatory, around growing particular business lines and there was a lot of focus put within the Commercial Banking space this year, as well as one or two areas within Retail Banking and Wealth Management. The restructuring and reshaping that went on within Retail Banking and Wealth Management from a cost perspective was very positive.

The things which, notwithstanding customer redress and fines and penalties in the US – both of which are damaging on so many different levels and clearly had very, very significant impact on the cost base – the things that we need to do better is the – if you like, looking forward three of four months and seeing those things that we are working on from a reshaping and restructuring perspective and building a better understanding of the costs associated. We understand, if you like, the benefits of what we're doing, but understanding what the possible costs will be.

And I think the best manifestation of that disappointment was in the fourth quarter: we saw quite a lot of costs coming through that did relate to restructuring projects, some of the reshaping of the real estate portfolio in the UK, some of the legal costs associated with what we had to deal with in 2012 came through in the fourth quarter. And they were going to come through some time during the year; I just would have preferred we'd had better line of sight to them at an earlier point in the year. So I think, for me, what was a little bit disappointing was the fourth quarter cost performance, but when the team dug into it – which they did, in nauseating detail, which I'm sure I drove them all to distraction on – we got down to, you know, the dollars here and there that were affecting that. And there were about half a dozen large items which related to – some of it was investment in the business, some of it was restructuring the business, and some of it had to do with regulation and compliance. And in my view, with one or two exceptions, we should have been able to see that, you know, probably four or five months earlier.

So I think greater predictability around the performance of the cost base is what I'd like to see and what I'm probably driving the CFOs a little bit around the bend on. Just get more granular and get more connected to the businesses so that we know, way ahead of time, what's coming.

Michael Helsby

Thank you. I was just wondering on the levy, because the levy fell in 2012, actually, the amount you booked. Clearly, there's been a rate rise or a levy rise, so shall we just apply that…?

Iain Mackay

No, the net effect was on the 2011 levy. The team did a huge amount of work around the granular implementation, because this is an incredibly complex levy in terms of how you apply it to different lines within the liabilities of the bank globally. And we have one person who literally spends his life working with businesses around the world and that life paid off big time in 2012 because we got a credit of over $90 million against what we paid in 2011, simply by getting better granularity, better understanding of the balance sheet, netting out certain positions and qualifying things that, within the regulations, attract a lower rate of the levy than a higher rate of the levy and that resulted in a credit on 2011 of USD99 million. So that reflects the reduction in the charge this year. The rate did go up, so the gross charge was higher, but the net effect of the USD99 million credit was what came through. So that particular individual paid for himself many, many, many times over.

Michael Helsby

He just didn't get a bonus, or his cap's at 100%.

Iain Mackay

He did get a bonus, I can assure you. He won't next year. You'll see the rate go way up next year because he's totally disincentivised and decides enough's enough.

Michael Helsby

But for 2013, though, should we just apply the levy increase to that? Is that all that efficiency…?

Iain Mackay

We have from a planning perspective, yes.

Nick Collier

Okay, Iain, Russell and team, thank you very much for hosting today's Q&A. Thank you everybody for coming along and giving your time. Thank you.

Iain Mackay

Thank you very much.