HSBC 2011 Investor Day

Global Banking and Markets

Presentation by
Samir Assaf, Chief Executive Officer, Global Banking and Markets

11 May 2011

Welcome back everyone. My name is Samir Assaf. Many of you will know me from my previous role as Head of Markets and in January this year, I was honoured to take on the role of Chief Executive Officer of Global Banking and Markets.
First of all, Stuart and Iain and Douglas actually have not left the presentation. They will come back in a few minutes, but they are talking to the media for the time being.

I am delighted to have the chance to talk to you today, and I will use this session to show that Global Banking and Markets is a strong and sustainable global wholesale bank in a strategic, strong position with some key competitive advantages that are difficult for competitors to match. I will also show how we will continue to grow our business by reinforcing our client-driven model, enhancing our product capabilities, collaborating more and more closely with other customer groups and increasing efficiencies across the businesses.

Let's start now with a quick look at the operating context. As you know, emerging markets are the engine of global growth. Emerging markets' trade corridor that you have between Asia and Brazil or India and the Middle East are growing extremely quickly. In terms of market, Asia Pacific will account for over 45% of growth in wholesale banking revenues to 2013. That said, developed markets will remain important. Trade between developed and emerging markets will grow rapidly too. For example, the Germany-China corridor is increasingly important. These trends will be key for Global Banking and Markets over the coming year, and the challenge is to unlock the connectivity. Today I want to explain how we intend to do this.

Global Banking and Markets is focused on three key areas: first, our strategic, geographic and client footprints. Second, our sustainable model and future growth potential, and third, the strength of our core product capability and leveraging the strength of our balance sheet. Let's look at each one in more detail.

Our first competitive advantage is our global network connecting developed markets to emerging markets. We have four main hubs in New York, Paris, London and Hong Kong, three of which have exceeded $1 billion of PBT, and we have a network that connects future growth markets. We are present in over 65 countries; we have depth of presence with 4,200 clients in Global Banking and Markets and more than 52,000 clients in Commercial Banking. We have a strong presence in India, Brazil, Dubai, Mexico, and we are a leading international bank in China and obviously the market leader in Hong Kong. This is a competitive advantage that is very difficult to replicate.

We are already a top-five global wholesale bank by PBT. Our model actually starts from our clients. We serve the largest, 4,200, clients directly through global banking coverage. We deliver a full range of product and solutions to these clients. Seven of these products are already delivering more than $1 billion of revenue. Besides this, there are also increasing opportunities to offer solutions to the 52,000 clients of CMB, to the 100,000 clients of Global Private Banking and to around more than 9 million clients for Wealth Management and Retail Banking. This presents significant growth potential for our business.

Our second competitive advantage is our sustainable business model. This model has grown organically in scale and profitability. After several years of investing in the business, we've achieved a spec change. We've reached 9.5 billion PBT last year, nearly a 16% increase per year over the last four years. Our cumulative PBT for these four years was almost $30 billion. Our prospects for future growth are clear, and Q1 2011 shows continuing strong performance.

Let's take a closer look at our performance in 2010. It was resilient and highly profitable, despite challenging conditions. Our cost-to-efficiency ratio was just under 50%, within the Group's target range, and we have achieved 2.5% return measured against risk-weighted assets on Basel II for the period. As you can see, this business is diversified by product and by geography. This diversity shows the sustainability of our model. 46% of our PBT is coming from Europe and North America and 54% of our PBT is coming from Hong Kong, the rest of Asia, LatAm and the Middle East. So the importance of the network and the importance of the connectivity is clear.

Let me just stop one minute on the BSM to say that in 2009 and in 2010, we saw exceptional BSM revenues, but they are now stabilising as interest rates return to more normal levels, and therefore, trending downward. We expect to deliver more normal levels going forward from BSM.

Let's take a closer look at our client revenue base. Corporate clients are still at the heart of our business. Our client revenues came mainly from corporates through a diverse product range. We also have a very strong institutional business, which is well diversified and well balanced with recurrent revenue return. This shows how sustainable and stable our business model is and how different, actually, as Stuart said, we are from many of our competitors.

Our third competitive advantage is our strength in core product capabilities. Let me start with our very strong transactional banking business, which is recognised by the market and creates stable annuity revenue. In PCM, we are top three in 30 countries with over 3,000 clients. In HSS, we have over 1,800 clients and beyond our very strong position in sub-custody and in fund administration, we are starting to be recognised as a global custodian. In 2010, we ranked first in Europe and fourth globally.

Global transaction banking is actually a low consumer of capital, fully leveraging the HSBC network and the strength of its balance sheet. It naturally leads as well to ancillary businesses such as FX and stock borrowing and lending. It also generates significant deposits and liquidity, and a 1% rate hike would mean a material increase in PBT for this business. Knowing what the next move on interest rates will be, you can see the upside potential is significant.

FX, credit and rates are major businesses for us. Each generates well over $1 billion of revenue. We deliver here innovative solutions and execute major transactions. Our size and strength is increasingly recognised by the market, and just have a look at the Euro money and FX week and our DCM ranking, or let's take an example: We recently led for the Hong Kong and China Gas Company their one billion RMB five-year bond issue. This was the first ever Hong Kong blue chip company to tap the offshore renminbi market. Our global footprint and history in China positions us to help our customers benefit from renminbi opportunities. Peter Wong, Helen Wong and Mark McCombe will say more about that later on.

In addition, we were the sole bank acting as book runner on both inaugural benchmarks for, for example, the EFSF and the ESM and this shows our unique expertise in the European sovereign space.

We are strong in transactional and in market products, but are growing seriously our capabilities in event-driven products. Our project and export finance are already strong. We are targeting growth in cross-border M&A and we are building seriously equities in line with client demand.

Let's take an example of a significant transaction. We recently acted as joint book runner, joint lead underwriter and joint listing agent for the 1.6 billion equivalent RMB IPO in the Hui Xian REIT in Hong Kong. This was the first ever offshore renminbi IPO. It's still on the market, and we took multiple leading roles including financial advisors, joint lead arranger and equity investor for Sports Hub, for example, in Singapore. It was the largest public/private partnership in Asia, including providing 1.8 billion Singapore dollars for senior debt facilities.

I have explained we are in a unique position. We have a client base and a geographical position that can't be replicated, and on the top of that, we have a strong product capabilities, capital and brand. Our strong performance means that our business model is the right one, so we don't need a revolution. We remain emerging-market-led and financing-focused. We will continue to increase our focus on connectivity, but clearly, as my colleagues, Douglas, Stuart, Iain, have set out, there are significant headwinds to this business so we need to evolve, and we need to evolve to reinforce our client-led approach, to enhance core products and develop new capabilities, to collaborate more and more with other customer groups and to deliver a more efficient business to create space for potential growth.

The first aspect of this evolution is to reinforce our client-driven model. Our strategic focus is actually to be a top three bank to key global banking clients, and a top five bank in global markets. To deepen our client relationship and strengthen our strategic dialogue, we've hired over 60 coverage directors and managing directors in the last 18 months, and we will continue to make selected key hires at senior levels. We're focusing on client-led solutions. We don't want to deliver everything to everyone, as Stuart said. We want to focus on leading in key sectors and geographies and connecting our clients across these geographies.

For example, we have opened a China desk in Brazil and Australia. We have opened a Latin American desk in Shanghai and in Hong Kong recently. You will hear more of these examples of the connectivity in the regional presentation later today.

The second aspect of our strategic evolution is to enhance our global product capacities. We have already strong capabilities in core products and we continue to develop them through new e-platforms in FX, fixed income and prime services. We want to broaden our channels of distribution and product ranges and focus investments to protect markets and add revenues. We have established an energy solution offering with Total, the French oil and gas company. This is an alliance where Total manages market risk and physical delivery and we manage the sales and offering and the credit risk.

In HSS, we've been appointed fund administrator to Blue Crest recently, one of the largest hedge funds in Europe with assets under management of more than $26 billion. This is a great example of collaboration across different parts of the business, global markets and HSS to enable us to deliver derivatives, valuation capabilities as part of the fund administration service.

We are also selectively developing new capabilities. We want to increase our market share in equities. This is a question that you often ask and this has two key components to us: origination and distribution.

In origination, we have a superior position to help high-growth companies access equity markets for the first time, particularly in emerging markets because of our client base, balance sheet and presence in these major financial hubs.

In distribution, we are aiming to build a market share appropriate to the execution requirements of our clients so we're not going everywhere, and we are focusing on the markets and the clients that are highlighted in this slide. We're already one of the five largest distributors of structured notes actually to Wealth Management clients globally recognised by Greenwich, and we will make our distribution even stronger as we expand the wealth businesses. Paul Thurston will talk about this later on.

We're also developing our prime services capabilities to meet client demand. We're leveraging existing capabilities in custodies and equities and integrating them into an end-to-end solution with a key focus on our primary markets in Asia and in Europe. With regard to our prime services offering for hedge funds, we have already eight live prime service clients with total balance exceeding $10 billion, 12 clients are currently on-boarding, and just last week, we've been selected by some of the largest hedge funds in Europe like Jabre Capital, Tyrus Capital and Arrowgrass Capital Partners. The third aspect of our evolution is to collaborate more with other customer groups. This wider client base is what makes us different as Stuart said, and when we have a full suite of products to serve them, in CMB, with over 52,000 clients master group, we aspire to increase revenues by more than $1 billion in the near-to-medium term and retain with 9 million premier and advance clients. We have a huge opportunity to provide wealth related products, and in GPB, Global Private Banking with over 100,000 clients, as I said, we also have a big opportunity. We have already set up the family office initiative to improve coordination and coverage on the ultra high net worth individuals segment. In Wealth Management and PB, we're aiming to double actually our revenues from these two areas.

We have though a huge opportunity here to deliver new revenue. Take a recent example. We've acted for Reynolds, a CMB client as a joint lead arranger, a joint book runner and lead advisor on the $5 billion cross-border transaction. This showed our ability to deliver seamlessly across products, with financing, DCM advisory, customer groups, CMB and GBM and geographies, US, Asia and Europe.

The final aspect of our evolution is strategic reengineering to deliver sustainable cost saves. As we evolve to capture the new opportunities, we must be more and more efficient; first, by management of the headcounts, exiting under-performers and non-core businesses, but retaining and attracting high-quality performers, increasing offshoring and technologies, operations and finance. We can achieve cost savings in this only area between $80 million and $110 million.

Second, by efficiency gains from technology, we have already reduced trading platforms by more than 50% in three years, and our steps in this area will save between $30 million and $40 million.

Third, by sharing common support functions in PCM, HSS, and other Global Banking and Markets units. In smaller countries, we share with CMB actually, common platforms, and in this area we will be able to achieve $10 million to $20 million of savings, and finally, we will reengineer our transaction booking model in order to reduce the costs of continuing expansion. All of these steps will allow us to invest for growth in the future.

So, I trust I have clearly demonstrated our strong position. Our targets are a return on risk-weighted assets of 2% to 2.2% on Basel III basis and to remain within the range of Group cost-income ratio.

Finally, I want to leave you with this key takeaway. Global Banking and Markets is a robust and sustainable business. We have a fantastic client base and a geographical position that cannot be replicated. On the top of that, we have a strong – I would say very strong – product capability, capital and brand, and as I have set out, we have clear potential for growth.

With that, I will hand over to Alan Keir for the outlook for CMB, and I will be happy, with Alan actually, to take questions at the end of the session.

Thank you very much.

HSBC 2011 Investor Day

Commercial Banking

Presentation by
Alan Keir, Global Head of Commercial Banking

11 May 2011

Thanks, Samir.

Good morning. My name is Alan Keir, and for the next 30 minutes, I'd like to show you the value that Commercial Banking, CMB, brings to our firm. I'd also like to draw your attention to some of the strong growth opportunities that lie before us as a consequence of our strength, our heritage and our global position.

I'd like to start by talking about two themes that will weave their way through my presentation. These are broadly about the world becoming a more international and a more connected place. We know, and you've heard this morning, that looking forward in terms of world GDP growth, most of that is going to come from faster growing markets. We've also seen a shift since the financial crisis in the flows of FDI. Faster growing markets are now the major recipients, and we see trade over the next decade being driven out of six key hubs; the United Kingdom, the United States, Germany, France, Greater China which includes Hong Kong, and India. All markets we have a strong presence in.

Businesses are also becoming increasingly international. In a recent survey by HSBC, amid market corporates across nine key markets, 75% of those said that they already did business internationally. 74% said they'd be doing more international business in two years' time. When we did a similar survey for SME customers, 27% stated they did business internationally and that was expected to grow to 40% in two years' time. These trends give us opportunities and potential, and I'll talk about them later in the presentation.

If I'm talking about Commercial Banking, I have to start with what is at its core and that is our approach to relationship banking. This Firm, as you've heard, was started in 1865 to service the needs of businesses trading on the China coast. Relationships mattered to us then. They matter to us today. It matters to us that in the 1890 we lent six pence to a gentleman called Steven Marks to buy a barrel. Marks & Spencer is still a customer with us today. Or in Asia, we lent a young wealthy entrepreneur some money to start a plastics manufacturing business, and Li Ka-shing has gone on to become one of the most entrepreneurs in Asia. More recently, in the financial crisis, we helped our smaller customers with the launch of a $5 billion global SME fund, and at a more micro level, it's about helping an Omani Premier customer establish their granite house wares SME business in the US by providing banking facilities.

Because relationships matter, we've invested in an MI system that allows us to see the value of our relationships globally. We've got a process and a system that allows us to track cross-border referrals to ensure they go to the right place, to the right person and are executed in a timely fashion.

We know our customers expect us to have highly trained relationship managers, and we have internal academies to ensure that happens. And because customers look to us for their international needs, we know we have to second our best people overseas, and as of March of this year, we have 211 of our best people working overseas in the business, 20% up year-on-year. We also constantly benchmark ourselves against customer research so, for example, we've seen that 82% of SMEs in Hong Kong rate us as the best bank for international business.

The value of CMB to the Firm is more than just its P&L, we're part of a wider universal bank so, for example, working with Samir and his colleagues, we've been able to generate collectively revenues of $1.4 billion last year in selling foreign exchange, derivatives, global capital finance products to CMB customers. We've generated $4 billion of assets under management for the Private Bank, and 45,000 successful referrals for Premier in Retail Banking and Wealth Management.

Connectivity runs through CMB as well. The graph at the top right shows you the percentage flows of our cross-border referrals and you'll note from the importance of faster growing markets. In 2010, we did 15,000 successful cross border referrals, an aggregate transaction value of $15 billion. That is 77% up year-on-year. And it's no flash in the pan, for for 2007-2010, the compound annual growth rate of our cross-border referrals is actually 72%. In 2010, we also saw an interesting emerging trend. That was that the referrals out of mainland China doubled. Mainland China has always been a strong referral point for cross-border referrals, but I think it reflects the internationalisation of the economy and business in China that we saw a doubling of referrals out, and clearly that's an exciting opportunity for us as the leading international bank in China.

If I may, I'd like to reflect for a moment on our 2010 financials. Against a fragile economic recovery, our revenues grew 8%. This was in part underpinned by the export-led recovery in Asia but our net interest income also grew 5% and we remain well positioned for interest rate rises. Our fee income on an underlying basis grew 10% as we increasingly sell a richer mix of product, for example, with receivables finance, trade finance, Global Banking and Markets. Our profitability grew strongly underpinned by the revenue growth and by the nominalisation in loan impairment charges. In 2010, we saw 11 of our geographic businesses contribute $100 million in PBT for CMB. In the foreseeable future, we see 20 geographies passing that benchmark.

Continuing to invest in our faster growing markets is important to us, but we've done this and still kept the cost-efficiency ratio within the Group's target range. And although we grew our lending, our assets-to-deposits ratio remains robust.

Turning now, if I may, to something that is very much at the core of our capabilities and that is trade, whether that is open account or whether it's the more conventional structured trade. As open account becomes more prevalent in the world, we've continued to invest in our receivables finance franchise. We now execute this through 19 businesses and 19 geographies giving us one of the widest coverages of any financial institution. We're now ranked number two by client turnover, in international banking, a key success area for us. Whilst receivables finance only account today for 4% of our revenues, we see strong growth potential in this area.

Turning now, if I may, to more traditional trade products, and you can see from the graph on the top right, that we've been able to grow our trade revenues at twice the world benchmark. We believe we can continue to grow our trade business, whether it's through conventional trade by being a leader and growing it quicker than market, by continuing to roll out receivables finance. We believe there's an opportunity for us in commodity trade finance where our geographic spread and our customer coverage enable us to reach right down into the commodities supply chain. And there's an obvious opportunity in China linked trade.

Trade is also a revenue-enhancing opportunity for us because it normally comes with good cross sales whether that's foreign exchange, remittances or insurance. Trade and receivables finance are also capital efficient products, so dollar for dollar, a dollar of receivables finance lent will generate twice the return of a dollar overdraft lent. We also see opportunities in RMB trade settlement with the internationalisation of the RMB. We have been able to successfully complete RMB trade settlements in 24 countries and across all six continents. When you put all this together, we see the opportunity to grow trade from its current revenues of $2.5 billion to $5 billion in the foreseeable future.

I'd like to turn now to how we can take CMB forward through focusing on four key strategic areas. The first of this is our continued focus on faster growing markets. I'd like to pause there just to clarify something. It's not just about investing in Brazil or China or India. It's also about supporting, for example, in developed economies, a manufacturer of yellow plants who's seeing export orders rise as a consequence of infrastructure projects in faster growing markets or it might be working with an SME whose end buyer has decided to move the supply chain to a faster growing market to be closer to the customers there.

I'd like to touch upon the way we're going to work going forward with Global Banking and Markets, where we see, as Samir's reference, a $1 billion upside. I want to look at how we can tap the potential of the trend of the internationalisation of SMEs and finally, I want to touch on how we can drive efficiency through the business.

Focusing on faster growing markets, you've heard – but it's worth repeating – that as you look at the next 30 to 40 years, of the top 30 economies in the world, we see 19 coming from geographies that are currently today called faster-growing markets, up from 14. We expect China to be the largest and India to be the third largest economy. HSBC is very well positioned to take advantage of that where we can connect, for our customers, developed and faster-growing markets. Moreover, we have deep growing franchises and faster growing markets themselves. Putting this another way, faster-growing markets contribute around 30% to world GDP, but for the commercial bank, we generate 50% of our revenues from there and 60% of our profit. Simply put, we're already positioned for the future economic potential.

We also understand that our geographic coverage gives us the opportunity to look at, for example, the fast-growing south-south trade so commodity finance between China and Brazil. To execute against these strategies we will continue to refocus and increase our asset and investment allocations in faster-growing markets. We believe there's an opportunity in what I call product transference because as faster-growing markets mature, the customers they're in will require more sophisticated products. We have those products, processes and systems in our developed market businesses and we're going to lead the transfer of those into faster-growing markets. We also believe there is upside in commodity trade finance which we believe can be a $500 million revenue business for us in the short-to-medium term. If you consider our position in faster-growing markets and our leadership in trade, we're effectively a leverage play on global growth and trade. That's why we will continue to target the CMB business, to grow its profitability at twice that of world GDP.

Turning now as to how we intend to work with our colleagues in Global Banking and Markets. As banking regulations tighten, banking capital will become more expensive. Liquidity pools will concentrate. Mid-market corporates who want to expand will therefore increasingly wish to look at public markets, whether debt or equity capital markets. Moreover, as faster growing markets go through their natural growth, coming through will be more mid-market corporates there. They again will require access to these markets to fund their expansion. There's also an opportunity, with economic uncertainties, to improve our cross sale of risk mitigation products such as derivatives. We are already positioned in this space. Working with Samir and colleagues collectively, we generated $1.4 billion of revenues in 2010. It's also worth saying that I think we can execute well here because of our core focus. You've heard how important CMB has been to the group over the years. Whilst most other institutions have had a wholesale or a retail focus, we have 146 years of understanding of mid-market corporates.

To enable us to generate the $1 billion of revenue, we are going to build a more consistent global operating model in the corporate banking space. We've already appointed enhanced leadership of this, and we intend to make sure that best practice is practice everywhere. We want to focus where the deepest profit pools are. We've already identified 12 key sites that we're already actively rolling out.

To bring alive for you what I mean by – when I'm talking about relationship banking or working with colleagues in Global Banking and Markets, I could have picked a number of examples, but the one I've chosen is of Godrej Group. For those of you who don't know the Godrej Group, it's a very successful Indian conglomerate. It has a wide range of products, FMCG, real estate, agri, security services, and it benefits from the patronage of 470 million Indians yearly. We first started the relationship with this Group 35 years ago when it was a small, domestic business turning over $25 million, but it had international aspirations. We started working with simple domestic products, then simple international products, and that led eventually to us financing an acquisition for them for a business in South Africa. This, in turn, enables us to work with our colleagues in Global Banking and Global Markets and become sole arranger and sole advisor on the Godrej's acquisition of Megasari.

Our two groups are strategically aligned. We've grown up together. We know the value that there is in faster-growing markets. Whilst we are the Group's leading banker, we're not complacent. We see opportunities to expand our relationship through, for example, cash management in Latin America or increasing our wallet share domestically in India.

Our third area is the internationalisation of SMEs and in this respect, I want to go back to the opening slide and just to recap, this was a survey that showed that today, 27% of SMEs do international business. This is likely to grow over the next two years to 40%. This is an important trend for us for a number of reasons.

First of all, we know that an international customer will generate, on average, twice the revenues of a purely domestic customer. Secondly, we know that our brand appeals to those businesses who do international operations and also aspire to do so. HSBC is clearly well positioned to take advantage of this trend. We have 3 million SME customers globally. We can compete and we can leverage scale. This can be either through our physical presence, branches on the ground, relationship managers, but it can also be through leveraging additional platforms so, for example, today we are the leading direct bank for business in Europe.

We understand that SMEs want to have international relationship managers and we have specific training and people dedicated to that. We understand they want access quickly to international platforms to carry out their business. Interestingly, we know they really value knowledge. The delivery of knowledge to them, particularly online is very important. We've established a business-to-business network and the ability to convey knowledge to them through online content such as Country Guides. To enable us to successfully execute this we will ensure that our SME franchises prioritise the acquisition of international and internationally aspirant SMEs. We will internationalise our platforms to ensure that our SME customers can transact cross-border remittances, trade finance, receivables finance online, making it as easy for our SME customers to do business overseas as they do at home and to do it online. We'll continue to generate knowledge and convey that to our customers. They value it, but equally, we recognise that we have some legacy domestic SME positions in some geographies. We need to evaluate those, find out if we can reposition them internationally and benefit from connectivity, and if we cannot, then we must exit.

Moving now to driving efficiency through the business: This will, as Sean highlighted, primarily come through the delivery of a global target business model. We know in any large organisation, there will always be local initiative, and they make perfect sense in the local environment, but they can, on occasions, distract from globally material initiatives. Working with our regional colleagues, we are improving our governance of our projects, products and processes. In effect, we want to deliver more power from the same punch. We also know there's an opportunity for us in the digital space. The American Bank Association research recently highlighted that most businesses now value their internet connection with the bank as highly as anything else. We're well positioned to execute against it.

We already have a cost efficiency ratio within the group's target range. We have developed offshoring capabilities. So, for example, a UK relationship manager will have a spreading of balance sheets of his or her customers done by colleagues in India. We have already identified where we are going to spend our IT and that is going to be on trade, on our digital platforms, on improving our cross-border account-opening process and on driving efficiencies through our credit process.

So to drive efficiencies, we will implement a target business model. This will mean that we will centralise our support function, currently 23% of our costs. We will look at the cost of running the business whether local, regional or global, to de-layer and to create efficiencies. We will reduce the number of IT processes and applications we run. We will drive operation efficiencies through the business.

An example of this is the relationship management capacity model. If we look at our relationship management portfolio loads across the globe, they are varying. If we take our best practice and deploy that globally, we can achieve 5% to 10% efficiency gains. Or, in other words, we can continue to grow our revenue without having to hire a further 600 to 1,000 relationship managers. We will leverage the benefits of our investment in technology. For example, a manual payment costs $4 to process but a straight through payment cost 27 cents. And we will leverage our offshoring capabilities. Today we have 1,500 FTEs supporting the business offshore, making sure we've deployed best practice, doing things simpler, cheaper with pure handoffs and less errors. We believe we can double this in the short-to-medium term to 3,000.

To conclude, CMB has been a core franchise for the group from its inception. We have delivered value and we will continue to do so through generating a return on risk-weighted assets of between 2.2 to 2.5, and we aspire to do this with a cost-efficiency ratio that will be below the Group's target range. We can do this through leveraging competitive advantage whether it's a leadership in trade, working as part of a universal bank and leveraging Global Banking, Global Markets. At its heart is a relationship banking model that's been tried and forged in the heat of competitive battle for 146 years and one we believe works.

Thank you, and with that, I will hand over to Stuart to host the second session of Q & As.

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Customer Groups – Part One

Questions & Answers

11 May 2011

Stuart Gulliver, Group Chief Executive

Thanks, Alan. Thanks, Samir. So we've got roughly 30 minutes or so of questions before we break for lunch, and actually, I'm going to do it the opposite way around this time because Sunil is back on the line, so if I could ask the operator, because it's probably late, I'll ask the operator if we could take a question from the call first before I open it up to the room if I may.

Sunil Garg, JP Morgan

Stuart, thank you very much for the consideration. One quick question on what is labelled as slide 67, where you talked about exceptional BSM revenues in 2009 and 2010 and now coming back down, could you perhaps give us some idea on, you know, how this slide would stack up on aggregate GBM revenues?

Stuart Gulliver, Group Chief Executive

We think the kind of normalised run rate for balance sheet management, all other things being equal, is around $2.5 billion of revenue, but bear in mind that this is pure interest rate risk and in earlier times, in 2004 I think it was, we managed to get caught by the turn in rates and it went as low as $700 million, but we believe that the sort of the normalised run rate, because it's been a lot of work that actually John Flint before he moved off to run Asset Management, Thierry Roland and Samir and the team have done – kind of $2.5 billion is sort of normalised run rate for this, all other things being equal.

Sunil Garg, JP Morgan

$2.5 billion for the half year?

Stuart Gulliver, Group Chief Executive

No, $2.5 billion for the full year.

Sunil Garg, JP Morgan

$2.5 billion for the full year. Just to, you know, I guess my question was more that, you know, if you look at even the aggregate GBM revenues helped both by BSM and also, I guess, a much wider spread in the environment, we're looking at about $20 billion in 2010, $22 billion in 2009. I mean, where would you hazard a normalised number in this? Any estimate of those?

Stuart Gulliver, Group Chief Executive

I think that becomes dangerously close to the type of stuff I'm not meant to do actually.

Sunil Garg, JP Morgan

Okay.

Stuart Gulliver, Group Chief Executive

So I don't think I can answer that.

Sunil Garg, JP Morgan

Okay, thank you.

Stuart Gulliver, Group Chief Executive

I mean, I'd like to help build a model, but I don't think I'm allowed to. Sorry, Sunil.

Sunil Garg, JP Morgan

Okay, thank you.

Stuart Gulliver, Group Chief Executive

Thank you. Okay, let's start on this side because we were a bit, sort of, – sorry about that, you should change chairs later on!

Philippa Rogers, Goldman Sachs

Thank you, Philippa Rogers from Goldman Sachs. I wanted to go back to the five filters and talk about two sets; one is the turnaround improvement and one is the discontinued dispose. Can you walk me through what percentage of RWA or ballpark some type of RWA that's in those two categories at the moment?

Stuart Gulliver, Group Chief Executive

We haven't got that to disclose at this moment in time. The very big lumps of RWA sit in the two portfolios that we indicated were the headwinds, so it's the SIVs and conduits in Global Banking and Markets, the ABS held under available for sale, and it's the rundown of Household, okay? If we then do dispose of the card business, that's the other very big chunk. You'd expect me to say this. The very large countries, by definition, fit into the most likely top 30 economies in the world in 2050, so they're going to be – if they don't hit the financial criterion, things we need to turn around, so unlikely to be big shifts in RWAs. The shift in RWAs is likely to be in North America or in Global Banking and Markets from the rundown portfolios. And that will shift the mix, because by definition, as the portfolios run down, they will hopefully not consume additional capital as we go forward, and if we do, and as I say, we are at the very early stages of looking at this, if we did dispose of the credit card business, then that would release some capital, but then we would probably redeploy some of that in building out the commercial banking piece in the US. The AFS piece, ABS, available for sale, that tends to run down over the next kind of three, four, five years but that's quite a long-tailed piece of work. But in terms of things like, you know, exit retail banking in Russia, that's not going to have a major effect on risk-weighted assets.

Philippa Rogers, Goldman Sachs

Sorry, on the restructuring?

Stuart Gulliver, Group Chief Executive

On the restructuring?

Philippa Rogers, Goldman Sachs

If it hits your strategic but it doesn't hit your three filters, can you give me some idea of the RWAs associated with that bucket and initiatives…

Stuart Gulliver, Group Chief Executive

Well, that will be basically a lot of the stuff that will be explained in the geographic presentations that come a little later, so that's kind of continental Europe, the UK, etc. which are going to be reasonably large consumers of RWAs. As I said earlier, France is an incredibly important country to us, but actually, some of its financial numbers aren't now in the space we need them to be in, but again, you shouldn't see that in terms of reduction of RWAs. That's going to be improvements of returns against those RWAs.
Iain, did you want to add something?

Iain Mackay, Group Finance Director

It's from the legacy portfolio particularly. What sits in Global Banking and Markets in CML is a total of about $180 billion of risk weighted assets, so that sort of gives you a sense, and certainly as those run off over the next five, six, seven years, the sort of effect.

Stuart Gulliver, Group Chief Executive

There is therefore effectively some capital being released and you're right, which is clearly why you are asking the question, and there is clearly capital going to be released from various of the reengineering that we do under the five filters analysis, but it gets very, very quickly to 'Give me a list of countries' and 'Give me a list of businesses within countries,' and as I said in the beginning, it doesn't make sense to do it in that way. What I would almost say is as we announce things, you should be able to refer them back to the logic of why we're doing it. Yes, please.

Michael Helsby, Merrill Lynch

Thank you, its Michael Helsby from Merrill Lynch. A couple of questions just keeping on the RWAs for GBM specifically, could you just remind us on what the inflation impact for Basel 2.5 and then Basel III will be for that division, and if you could, give us the exact number for the AFS risk weighted assets, that would be very helpful, and attached to that, in terms of your run-off of that portfolio whether you're assuming any losses to come through on that, and within your mitigation, what have you allowed for that?

Iain Mackay, Group Finance Director

I will tell you what, why don't you just give me your spreadsheet, and I'll fill it out for you, how about that?

Michael Helsby

To be fair I don't think it is about filling out the spreadsheet, it is about where it is at today?

Iain Mackay, Group Finance Director

Look, I think certainly from the perspective of… The run-off of these portfolios is obviously going to go across a long period of time, and we've given you some indication today of the likely impact that we will get in terms of the release of capital through that run-off period. In terms of what we're likely to experience within the ABS portfolio as we do that, certainly at the end of the year, we gave you some guidance around how the reserves had moved, what we were experiencing in terms of impairments, what we actually expected to incur in terms of economic losses. Now we continue to monitor that literally on a sort of day-by-day, week-by-week, month-by-month basis, and at the end of the first quarter in terms of where we expect to see economic loss is very, very much in line with the guidance that we provided at the end of the year in terms of full year results. So, as I mentioned, in terms of the total run-off from the ABS and legacy positions within Global Banking and Markets and the CML portfolio, taken together, those two represent approximately $180 billion of risk weighted assets which will runoff, and this is very varied. There are a lot of factors that come in to it but it runs off somewhere between really the next three to seven years, and even then, when you look at the CML portfolio in the US, you're likely – and Niall will certainly answer this in a great more detail than I could at this point, you're still left with a stub which is probably a fairly well performing stub of long-term fixed rate mortgages in the United States.

Michael Helsby

GBM inflation in terms of 2.5 and 3 in terms of how much it goes up?

Iain Mackay, Group Finance Director

Well, the vast – everything that happened that I laid out in that chart today impacts Global Banking and Markets. That's it, okay?

Michael Helsby

Yes.

Iain Mackay, Group Finance Director

2.5 is basically Global Banking and Markets. It's traded risk.

Michael Helsby

And just separately, just to hit on your comments, Stuart, about how clearly everyone's figured out that Asia is the place to be. I think all the investment banks in the US investment banks are desperately trying to build out their banking licences so they can attack your strength of FICC business, so I guess, clearly the pressures within GBM and in commercial banking in Asia, coming both on the margin side and on the cost side. So just trying to help us think about the underlying momentum and if you could tell us what type of volume growth you need to see to offset the margin pressure that you think is there, when you're talking and you are doing your planning, going forward. Equally on the cost side, what type of – assuming flat revenues – what type of efficiency savings do you need to make to keep a flat cost income ratio?

Stuart Gulliver, Group Chief Executive

Let me make a couple of introductory remarks and then Samir can talk in detail in terms of the numbers in Asia, but what you've described about the fact that the competition is intense in Asia isn't really that unusual. The competition is intense in every aspect of every business we do everywhere. I haven't yet, unfortunately, noticed a country in which we're the only bank – this includes Malta actually – in which we're the only bank, and actually, you know, the super normal profits just flood in, so I don't think you've described anything that's unusual. And frankly, in my entire 32 years in HSBC, Hong Kong's been the most competitive market imaginable. I mean there's what? 180 banks in Hong Kong, Peter, for 8 million people, so don't for a second think that Hong Kong is a non-competitive market and it's just heating up.

It was always thus and it's one of the reasons why, to echo Alan's point, you know, forged in adversity, we have such a good operation in Hong Kong as it's constantly had to compete in a massively over-banked market with a very small, limited population. So, I don't think that that's a particularly unusual or new thing, and during the time I was running the dealing room in Hong Kong and the dealing rooms in the rest of Asia Pacific, every year there was always a fresh momentum player that would come in off a two year unconditional guaranteed and have a crack. So, there's nothing new about this, quite honestly.

And you're right. There are a number of banks seeking local banking licences because the big competitive advantage that we have had and continue to have, is we have local currency funding, so we have retail deposits, 'retail' defined here as either commercial banking or indeed, retail banking deposit, in local currency, in country. And that's why we have a considerable advantage over a US bulge bracket that doesn't have access to local currency funding, and, of course, we don't give them that access either, so in our FIG relationship, we don't give committed local funding lines to our competitors. Because actually, in order to do, to take an example, you know, underwriting Malaysian ringgit sukuk you need access to Malaysian ringgits. If you want to do Malaysian ringgit derivatives, you need access to Malaysian ringgit.

Now, I have no – I can't comment on the regulatory appetite to let new foreign banks in to these countries, post the financial crisis or indeed, what capital those new entrants will be required to keep in those countries in order to satisfy the local regulators, but obviously, the Asian central banks learnt a hell of a lot from the 1997-1998 Asian crisis, and actually, therefore have been really kind of leading in terms of prescriptive, active regulation of their banks. We, in Hong Kong for example, are very comfortable with the notion that Hong Kong monetary authority quite rightly sets maximum loan to values on mortgage lending and defines the maximum you can lend. Defines the maximum you can lend on properties worth more than $1 million etc., so I'm not so sure it's that easy actually to get local currency banking licences in Asian countries, but the competitive position has always been relentless, because actually, most people worked out the large demographic and economic shift change from actually Deng Xiaoping's tour to Southern China in 1979, so this is not actually kind of, you know, fresh this year.

In terms of margin compression and so on, I'll ask Samir to have a crack at that one.

Samir Assaf, Chief Executive Officer, Global Banking and Markets

I will make two remarks: the first one is actually, if you look to our Asian business, the opportunity of growth for us is still tremendous, because simply look to the equity part of our business: we were not really present in the equity markets in Asia, despite the fact that all the Asian clients, mainly the large China, are booked and take money from us. So the equity opportunity of growth for us in Asia, and the event business related to this opportunity is a real opportunity for growth and taking business from others.

The other side is the local currency business, and definitely, no one can execute better than us on the renminbi and with the internationalisation of the renminbi, and, as well, in the other local currencies. Just if you look to the league table of the renminbi bond market for the time being, we dominate this league table with 30% market share. The third thing is that actually with the international banks coming to Asia are focusing on the top 10, top 15, top 20 clients. While we have the balance sheet depth in Asia we are going much deeper. And that's why, with Alan and his team, and as well for the retail markets in Asia, our opportunity – so the way that we factor it is the following: we grow at least with the market, and at best we have areas to go where we are not yet.

Stuart Gulliver, Group Chief Executive

And there's another opportunity as well that – obviously I wasn't here when Samir gave his presentation, so apologies if you have already presented on this – but, as I said earlier, international companies, funnily enough, have the same markets that they are trying to build their businesses in. So if you go and meet an auto manufacturer or an engineering company, you know, they also see the emerging markets as their big growth story. So they then very quickly need payments and cash management services in local currency; well, they are going to do that with a bank with a local currency funding base, because clearly you can't provide the sweep overdraft unless you've got actually the money.

Secondly, actually as investors start to invest in the growth story that we have just outlined, they are going to need custodian arrangements; they are, again, likely to go with custodians that have been there a very long time, and have access to the local currency market. So absolutely it's competitive, but I don't think that in any way invalidates the opportunity that we still see for HSBC. Yes, please?

Bill Stacey, KBW

My first question is about the two presentations, and both of them referred to Africa as a place that is an important trade market. I am just wondering, given the capabilities you have in Africa at the moment, is there any gap or what additional capability or presence would you need in Africa to meet the requirements of both of your businesses today going forward? The second question is more about Commercial Banking: you talk a lot about defining a global business model. I'm wondering, of the business models that you have at the moment in the major markets, where is the most change required, operationally, organisationally, to get to what you see as that global business model being.

Stuart Gulliver, Group Chief Executive

Alan, if you want to take the Commercial Banking one, and then I'll answer the African one second?

Alan Keir, Global Head of Commercial Banking

I think clearly the ones where we have domestic legacy SME books, and that aren't producing the right return, there's no connectivity, and that is the first port of call: we have to look for reengineering, but also working with the regional colleagues will be areas where we need return improvements under the five filters through cost efficiency. So I think the first port of call, as I tried to lay out, was where we have domestic SME books that are subscale, can't really compete, don't really give a return, no international upside, no connectivity: we really should not be doing that. And the second area is working with regional colleagues where there are cost efficiency gains to be made, and that is predominantly where there are today the highest CERs.

Bill Stacey, KBW

In UK and Hong Kong, where you happen to have the biggest commercial banking businesses, which one of those is closer to the operating model that you see as being the global model?

Alan Keir, Global Head of Commercial Banking

Well, actually, they are both quite similar in a way; there is not actually much between them, although the cost efficiency ratios are quite different. I think the UK needs to become more international, and more internationally focused, and I think that's fair, and they are already on a trend to do that, and you'll hear more of that from Brian, and I don't want to steal his presentation on that. So that will reassure you on that. But clearly the jewel in our crown is Hong Kong where there is tremendous depth of understanding with the relationships, it drives tremendous value for Global Banking and Markets, and both of them actually operate off a similar model. It is actually taking those models and deploying them elsewhere that I think is the bigger goal.

Stuart Gulliver, Group Chief Executive

In terms of the Africa question, which I guess is a bit of a disguised way of referring to the Nedbank transaction: actually, an awful lot of the China – Africa business is government-to-government. Actually there is not a lot of financing that actually the private sector is going to do in it. We said at the time that the Nedbank transaction just simply didn't hit the financial criterion, and actually that was an early kind of workout, quite honestly, of the five filters approach.

So the opportunity in Africa we will need to pick up organically through the presence that we have on the ground there, but I wouldn't want, at this moment in time, to get a sense that there's a substantial amount of revenue that we're missing. A lot of the very big stuff that involves the Chinese government is government-to-government and actually quite a bit of it is done as barter, so therefore it isn't financeable. At the SME level there will be opportunities, but we believe that we have sufficient presence on a ground to be able to capture those that are coming out of our client base.

Kian Abouhossein JP Morgan

Slide 64: can we talk briefly through the dynamics, because if you assume the balance sheet management of $4 billion becomes two and a half, and I assume this is a very low cost income ratio business, meaning that the 50% cost income that you are achieving today would actually have some headwind. And is it very much a revenue story that you are outlining in this business, and, in that context, Global Markets you indicate upside globally, on one of the slides, I would think you are maybe half of the top five in that business in terms of revenue generation? I am really trying to understand what are the drivers, in a bit more detail, the outline – first of all, is my rationale right? And secondly, what are the drivers in terms of the revenue story in Global Markets because that seems to be the main delta?

Samir Assaf, Chief Executive Officer, Global Banking and Markets

Well, it is relevant your story, and, as I said in my presentation, the potential for growth is serious for us. It is a revenue story mainly coming from the client base, and the markets where we are positioned, and if you look to at least the equity business, we can definitely, and we are aiming definitely to create much more value from this business. We have said that we are opening a prime broker, or prime service business; we are involving ourselves in the energy business, where we were doing nothing actually until the last few months. We can do much better still in FX, and the revenues are coming as well from the products that we are rolling out to the other customer groups. As we have said, spoke about Commercial Banking, but we spoke, as well, about Retail and Wealth Management.

So these are mainly, you know, the areas from a product perspective where we are growing. We think that we can do more in the event business, as well, actually. From a geographical perspective, as I said, Asia is a real opportunity of growth for us, and connecting Asia to the rest of the world is a real opportunity of growth. When you look geographically how we are present in Brazil, Mexico, and Argentina, how we are present in France, Germany, and the UK, and for what we are doing in the US: if the world will grow we will be growing at least with the world, or , because we have still product gaps, at best much better than what the world is growing in the next few years.

Kian Abouhossein JP Morgan

If you are losing $1.6 billion on revenue and I assume that's a cost income of about 20. It is a treasury business more or less. Then you have to grow your revenues in Global Markets significantly to offset that and keep the cost income of 50 – is that correct?

Samir Assaf, Chief Executive Officer, Global Banking and Markets

Yes, we have said that in Q1 actually we had a very strong Q1 because we have not disclosed the numbers from a business perspective, and the Q1 actually showed some BSM revenues going down. Other areas actually we've seen growth in revenues, and I think that the trend is there. I have not mentioned the custody business, where we can do more.

Stuart Gulliver, Group Chief Executive

The thing you are missing on this is there are three businesses that also have very attractive cost efficiency ratios, because I think what you are thinking is BSM is 20, and probably looking across to JP Morgan, you know, M&A is 80 to 120, or something similar. Actually, what you are missing is that securities services, payments and cash management, and the other transaction banking pieces have pretty low cost efficiency ratios as well, to the extent to which there is a 1 billion, 1.5 billion across those three revenues that is coming in at the same kind of efficiency ratio. I think that is the bit that we have probably not made crystal clear as to how the maths may work.

Samir Assaf, Chief Executive Officer, Global Banking and Markets

And can I just keep repeating the same thing, you know, look to our customer groups and look to where the revenue is coming from for Global Banking and Markets, and you will see that the franchise of it, the depth of it, the stability of it, is different, as Stuart said, from the other investment banks. So our revenue stream is actually not only stable, but very much linked to what is happening in the economy and in trade, which is, as I showed in the slides specifically, 50% corporate, and within the institutional space you can see what is volatile and what is not. It is a different business model.

Stuart Gulliver, Group Chief Executive

This comes to my earlier point: we have not done a good enough job in the past about explaining how different this is, which is why we have effectively got the same valuation as a BarCap or a Deutsche Bank, but it's actually a very different business model, because it reflects the countries that we operate in. I need to take one call, because we've got another call coming in on the webcast, so operator, can I get the call that's waiting?

Stephen Andrews, UBS

Thank you Stuart. It's Stephen Andrews from UBS. I've got a couple of quick questions please: the first, is just on the business to potentially be disposed of, and that feeds into the cost income ratio on the second question. Just looking at the businesses on the the five sort of deciding factors that you've outlined, things like the US card business, my sort of back of the envelope maths suggests that roughly 10 to 15% of the Group's operating profit is potentially for sale. Can you just perhaps clarify if that 10 to 15% is the right ballpark, because that's quite a big hole in the P&L to fill over the next two to three years?
And then the second question is just the 48 to 52% cost income, does that factor in these disposals and, if so, what sort of impact on the Group cost income would you expect these disposals to have. Thank you.

Stuart Gulliver, Group Chief Executive

Well, actually if we did manage to sell the card business in the USA it actually would have a negative effect on the cost efficiency ratio, and on the ROE, because its ROE is higher than the Group's and its cost efficiency ratio is lower. But I think if we're going to actually have any credibility about sticking to the five filters it is non-strategic, and those first two filters of connectivity and economic growth really need to be the entry level ones, the financial ones then being the second test. Ian, you might want to talk about revenues for sale?

Iain Mackay, Group Finance Director

Yes, certainly. In terms of back of envelope, certainly you can derive this from US filings, the cards business does throw off somewhere between 1.5 and 2 billion on a pre-tax basis. However, I think one of the things is certainly within the US regulatory environment there is some pressure, certainly, as it relates to cards revenue within the context of the Card Act, and the ongoing consumer protection bureau that is being put in place. So nonetheless I think Stuart's point continues to bear out; this has been an incredibly well managed business though the cycle and it is robust profitability for the Group, but not core.

Stephen Andrews, UBS

Thank you. And is the 10 to 15% roughly right?

Iain Mackay, Group Finance Director

Yes, about 10% is probably a closer number.

Stuart Gulliver, Group Chief Executive

10%, Stephen, is roughly right, but I think also – I don't know where you're calling in from – but you need to hang on and listen to Neil's presentation, because clearly some of this is going to be talked through in detail by Neil, because obviously what it immediately throws up is the need to aggressively restructure, and there is therefore an aggressive cost challenge comes about in the US, if we are indeed successful. If we managed to start this restructuring there are several other consequences that unfold from it that actually I haven't brought out in the overview. So hopefully you can have a really big, black coffee and stay on.

Stephen Andrews, UBS

Thanks, and it is already factored in to the 48 to 52% target range then...

Stuart Gulliver, Group Chief Executive

Yes, it is factored into the 48 to 52, and, as I say, if it goes ahead it is adverse initially.

Stephen Andrews, UBS

Okay. Thank you very much.

Stuart Gulliver, Group Chief Executive

Thank you. Yes, actually, yes – you've had your hand – just behind Robert, you've had your hand up for an awfully long time, and apologies, I switched sides, so forgive me.

Ronit Ghose, Citigroup

I just had a question for Samir, and maybe yourself Stuart: when you look at the GBM return on risk weighted asset targets, the delta, or the range between the 2 to 2.2 seems to be the smallest division you have given any business area. And normally, and maybe this is, again, just back to maybe talking about how your GBM is different to other banks, that is where you see the biggest variability. I am just wondering why you are so, why you are giving us such a narrow range?

Secondly, on a more organisational basis, and it maybe ties into cost savings, you both talked about trade and cash management, PCM in your business Samir, and trade in Alan's business, and I was just wondering if you could maybe spell out a bit more how tight together these businesses are. I mean, is this one big factory that happened to be separately reported, or in many other banks, be it a Standard Chartered, a JP Morgan, or a Citi, these would be sitting in pretty much one division. I'm just wondering how much more cost savings and / or revenue upside there is?

Samir Assaf, Chief Executive Officer, Global Banking and Markets

The narrow target – actually this target is a Basel III 2013, 2014. I believe that first the framework of the regulation is not yet very clear, and maybe some of the headwinds actually would be lower than what we are expecting. I think that we have set ourselves on the conservative side. That's first, and second, the run-off of the ABS portfolios etc, are not factored into these targets. So it's just to establish the scene actually, we are on, what we believe, the conservative side of the target, but it is coming from a specific and precise medium term outlook that we have done, and actually the Group has, and Stuart Gulliver and the GMB agreed in April. So we are very precise in what we can deliver in the next two to three years, and I am confident that we can deliver it actually. On the payments and cash management?

Alan Keir, Global Head of Commercial Banking

Yes, shall I do that? The business is run jointly by Samir and I, but John Coverdale who runs it for us globally is actually here in the audience. It is an important platform for both our customer groups, but we actually don't want it well divided, because then you get discontinuities when it comes to servicing the customers. Security services is clearly a Global Banking product, and Samir very much leads on that; trade, pretty much predominantly a Commercial Banking product, and I pretty much lead on that, and PCM sits in the middle. But there is no way that structure allows us to get in the way of driving cost efficiencies, and John has his goals around that for Samir and I, but it does enable us to make sure that we're deploying the right investment for the right customer opportunities regardless of customer group.

Stuart Gulliver, Group Chief Executive

Effectively there is one platform; there is not two silos, but in essence the relationship management and the product development and sales are done in Commercial Banking, in Global Banking, and then the lead will be taken on product development by Alan for trade, because it's mostly Commercial Banking, and most Global Banking clients would trade on open account, something similar. Payments and cash management is jointly done, and obviously the custodians are all financial institutions, so they tend to fall under global banking, but there isn't, there aren't two platforms, and John Coverdale, who is sitting at the back there, and will be at the lunch, is responsible for the platform.

Ronit Ghose, Citigroup

A quick follow up question for Alan: you talked about the revenue upside on trade, could you just put some numbers, some more numbers around that, or particularly just a timeline?

Alan Keir, Global Head of Commercial Banking

I think I said, forgive me if it wasn't clear enough, that, you know, we currently have a revenue from that wide business of around $2.5 billion; we see that doubling to $5 billion in the short-to-medium term.

Stuart Gulliver, Group Chief Executive

Okay, we have got time for one last question, please James.

James Alexander, M&G

Two questions, one on Commercial Banking: I am struggling to think of a country where you have got a strong Commercial Banking presence, but no big network presence. I am just kind of struggling a bit to think of these ones you might, small commercial loan you might get rid of, what sort of, you can't name the countries, but you seem to only have these really successful commercial businesses where you have got large networks like in the UK and Hong Kong – there is Brazil and Mexico, but...

That is one question, and the other question is on the commodity finance piece. I know one of the reasons why you were thinking about South Africa was commodity finance and you have said a lot of it is government-to-government, but we see some other large wholesale banks doing really pretty large revenues and profits from commodity finance, and it doesn't seem to be a big area for you.

Alan Keir, Global Head of Commercial Banking

On commercial banking we have got a number of viable franchise; I talked about exiting SME, not just the whole franchise. So we've got a number of places where we have, for example, large mid-market corporate franchises that don't require branch networks at all, purely connected internationally, connected with Global Banking and Markets, and these work extremely well indeed; and we manage those obviously through return and the connectivity filters. So the positions where we can exit are where we have straight into domestic SME without an ability to compete on scale, for example, through either a competitive branch network, or a competitive digital platform. So those are the ones where we would move away from.

It doesn't mean to say we'd close the whole business; it's just that part of the business, because clearly mid-market corporate in many of the world's leading geographies are very internationally connected and are a rich source for us of opportunities in trade, foreign exchange, payments and cash management, as well as just normal financing.

Stuart Gulliver, Group Chief Executive

So, in terms of commodities, you can split it down into the various different commodity groups. So the oil and gas approach is with the joint venture that we have with Total, where effectively they take the market risk, we take the credit risk, and that's actually started to show reasonably good traction with some of our, for example, airline clients in the Middle East and in Asia Pacific on fuel hedging. In the metals business we ourselves are a very large precious metals house, which came about when we bought Republic National Bank of New York. So what we're really talking about is the kind of metals and mining sector, and kind of iron ore, coal, miners. And actually we have a reasonably successful team, which is really represented in Canada, in the UK, and in Brazil. And a large number of those South Africans are obviously headquartered here actually. So although we don't have a presence on the ground, we have a reasonable share of metals and mining business, and we have got sector bankers and we do have research and so on.

To answer your question slightly differently, that particular acquisition would not have given us any progress in that area. They actually don't do that type of business, which, again, is one of the reasons, when we really got down to the final analysis on that, it didn't make sense. Right, we're out of time for this session, we are serving lunch on level 40. All of the management team from HSBC that's here will be at the lunch, so it gives you the chance to kind of meet the management team, and then we need to be back here just after 14:00 to start the afternoon session. Thank you.

HSBC 2011 Investor Day

Retail Banking and Wealth Management

Presentation by
Paul Thurston, Chief Executive Retail Banking and Wealth Management

11 May 2011

Stuart Gulliver, Group Chief Executive

I welcome you all back to the start of the afternoon session. The first block will be on Retail Banking and Wealth Management, and will involve presentations by Paul, by John Flint, who runs Asset Management for the Group, and David Fried who runs the Insurance business for the Group. And then followed by a presentation by Chris Meares, and then we will take Q&A on these particular two customer groups. As I said earlier, we have changed the name of Personal Financial Services and split it to actually designate and clearly delineate two very different activities that will now take place under this umbrella. One is the repositioning of our Retail Banking business for the reasons I set out this morning, and the second is a new initiative, which we think has substantial revenue potential, new revenue potential for the group, which is a build out of Wealth Management, albeit in a very focused way, in 18 countries. So I will now hand the floor over to Paul Thurston.

Paul Thurston, Chief Executive Retail Banking and Wealth Management

Thank you, Stuart, and good afternoon everybody. Thank you for coming back for lunch and staying on for the afternoon sessions. I was appointed to head up our Retail Banking and Wealth Management business globally in March. It is a renaming, as Stuart said, it is more than just a renaming. In terms of the accounts, what you will see in the future from the first half year results is Retail Banking and Wealth Management going forward will include not just our personal financial services business and the related bank assurance earnings, but also the net earnings from the asset management company. The renaming is more than a renaming, it is a change in approach to our business, and a statement of intent to focus on streamlining our Retail Banking business and growing out our retail Wealth Management capability in the Group.

I should start off by reminding you that the forward looking statements that you read extensively this morning still apply throughout the rest of the afternoon. And to kick off, to talk about the business as it stands today. We operate in 61 markets, we have 92 million customers. The financial results have clearly been dominated by the losses in the US consumer finance business. Whilst other parts of the retail business have remained profitable, they have been impacted by higher loan impairment charges in some of the unsecured portfolios and in other parts of the world, and of course, by a significant reduction in deposit margins. In 2010 the business returned to profitability overall with a return on risk weighted assets of 1%. But of course this continues to include the losses we are incurring on the run-off portfolio in the US, more than $4 billion in 2010, and that reduces the overall returns that we're getting, we're getting somewhat stronger returns in other parts of the business.

Over the last few years the shape of the business has changed. We have continued to attract deposits, adding $75 billion over the last three years without generating very much income from those in the very low interest rate environment. But we have also reduced the loan portfolio. Whilst we have, as you can see from the table at the bottom, been growing out our loan portfolio in some of the faster growing markets of the world, clearly that has been significantly offset by reductions in the United States. There has also been a mix in the portfolio as we have reduced some of the unsecured lending portfolios, but grown out mortgage businesses in some of the markets where we have been able to do so with attractive returns on high quality business.

Looking now at the trends that are impacting Retail Banking as an industry and the Wealth Management industry worldwide, and I think there are four themes that I would draw out and highlight for you. Clearly the first is that whilst interest rates will rise over time, my view and our view is that the competition that we see for retail deposits will hold down any significant growth in deposit margins. We're not anticipating a sudden or significant resurgence of deposit margins in the near term. The second is that, as you all know, the use of technology is impacting the way services are delivered to customers. The use of direct channels continues to increase, and the convergence of mobile and internet will just accelerate that trend. And we are seeing that not just for banking services, but also for access to Wealth Management services. This and urbanisation will make attractive customer segments more accessible than they have ever been before. Where economies are growing fast, as Stuart indicated this morning, wealth is being created at a significant pace in those markets. And as the GDP per capita grows, the demand for financial services grows. And as the savings pools grow, the use of alternative forms of investment also grow. But there remains still significant savings pools in some of the mature markets, which, in an age when people are living longer, and pension funds are notoriously underfunded in a number of places either at state or at corporate level, those saving pools are going to have to work harder. And in working harder that means not just being invested in the local economy, but also capturing the opportunities for growth from some of the faster growth markets. So the flow of international investments will continue.

Here are a couple of slides that just illustrate some of those trends. If you look at the top slide, you see the significant wealth pools in some of the mature markets, very sizeable. But if you look at the growth rates down the right-hand side, the numbers in black indicate the growth rates that we're seeing in some of the emerging markets. Another couple of slides for you as illustration. The one on the left indicates that as markets mature, savers tend to hold a wider range of managed products. They don't just hold their savings in cash. And the chart on the right shows that as GDP per capita grows and flow is down, you come to an inflection point where you see a real pick off in the demand for financial services. This case is based on life premiums.

How is HSBC placed to tap into these trends? We have a number of critical competitive advantages. The first thing I would say is that in any retail business brand is crucial, and we have one of the most powerful brands in the world, and backed up by the financial strength to convince customers that we are a good bank to do business with. That enables us, as you see, to continue to attract deposits, and that enables us to continue to grow our lending for customers. So we have the brand and the strength to continue to build our business. We also have unrivalled global propositions in HSBC Premier. The global view platform that comes with Premier enables customers to, with a single log on, access their balances in multiple countries across the world, and to move money to fund their accounts from one part of the world to another part of the world instantaneously. No other bank has the capability to do this for their retail customers as we do. This is a world class transactional banking platform. It's true that we have not yet exploited it to make it a world class Wealth Management solution globally, but it's a fantastic platform that we can build on.

And of course, as a universal bank, we have the capabilities to access a wide range of Wealth Management products and solutions, either to manufacture them internally or to source them, and critically to give our customers access to the world's markets, to enable us to use our network to provide benefits to customers through giving them opportunities to make their savings work for them internationally. In the Wealth Management business customers may not always be internationally active, but their money certainly is, and should be. And this is where the network effect comes in for Wealth Management.

Turning now to the portfolio that we have, and you can see, as we've talked out before, and Stuart introduced earlier, quite a concentrated earnings picture across the different businesses in different geographies. Clearly we have very large scale in Hong Kong and the UK, and they make the majority of our earnings today in the retail businesses. But in the next tier you will see that we have significant presences in 13 markets that we believe are attractive because they are fast growing, already have large pools of wealth, and we have more than 3,400 branches across these markets, giving us good access to key customer segments. The earnings last year across these businesses were just over $1 billion, but we see real potential to grow in those markets.

Next, we are investing for the future opportunities that we see in China and in India, and clearly we are investing more than we are generating in profits today, but those are critical markets for us to continue to build out our presence. Next, we have a group of four countries where we have leading market shares, but in relatively small markets. So they generate profits, they are decent businesses, but they are not going to have significant long term growth prospects. But underneath that you see that we have 39 markets where we are generally subscale and unprofitable. Some of them do provide funding to the rest of the bank, but as configured today, you can see that is not necessarily a cheap form of funding because running a Retail Banking business is not a cheap thing to do today.

And of course at the bottom we have the business in the US, which Neil will talk about in much more depth later on this afternoon. So our strategic goal across these businesses is to drive a sustainable improvement in the returns that we're generating, and we will pursue three strategies over the coming years to achieve this. Firstly, we will develop world class Wealth Management capabilities for our retail consumers, building on the base that we already have. Secondly, we will leverage our global expertise in Retail Banking to streamline and standardise that business, and generate cost efficiencies. And thirdly, to actively manage the portfolio going forward to ensure that we are focusing our investment in businesses where we can get attractive returns.

Let me take each of these in turn now. Firstly, Wealth Management. We are embarking on a centrally managed programme to build out our retail Wealth Management capabilities. This will impact necessarily all aspects of the way we do business. It will impact the way we generate products, we package solutions, we develop propositions, the way we do asset allocation models and run investment strategies for our customers. It will affect the way we manage sales at the front end of the business, the tools that we give to our salespeople to enable them to manage relationships, and indeed the tools, the information that we give to our customers to enable them to track their performance. Fortunately we are not starting from scratch. We have considerable experience and platforms on which to build. We have a number of areas of excellence around the Group. What we haven't done is created one single pool of excellence across the whole group. We have built in Hong Kong, from a standing start again, just over 10 years ago, a bank assurance business that today, from zero, is the leading bank assurer in Hong Kong. We are number 2 in sales of mutual funds in Canada. We have a well structured Wealth Management business in France. So we have a number of areas of expertise. We have the platforms with the Premier, the global view that we can build on and enhance to deliver not just banking solutions, but Wealth Management solutions to our customers. And through One HSBC we have been working with Global Banking and Markets to build the transactional platforms. As Samir has been developing the equities business, we have been linking into that, and are getting into a position to be able to provide transactional securities processing services to our customers. And just recently we launched US equities trading for our customers in Hong Kong. That is what we can do by linking much more closely into our markets abilities. We will pull these strengths together globally and build a robust, consistent and quality Wealth Management capability for our customers. We see particular potential in the segment of customers with investable assets of between $1 million and $5 million.

Historically these customers have been tended to be underserved in both retail banks and private banks, and between us, Chris Meares running the Private Bank and I will build compelling propositions for these customers.

In the past we have talked about a target to grow our Premier customer base to 6 million, and we are pulling back from that as a standalone target. That is not because we do not think that level of customer base is achievable. We have clearly grown very rapidly. We have 4.4 million Premier customers today, grown by 1.7 million of those in the last two years. So it is not a question that it is not achievable. The key is to focus on deepening the existing relationships. Within our existing customer portfolios, if you look at the securities and investments held by our customers it probably makes up today only around 20% of total relationship balances. Now that would be against a market norm for the businesses we operate of maybe 40% to 50%. If we were able to get our customers up to that sort of level, that would give us a revenue opportunity of around $4 billion. And we believe that with all the developments that I have talked about in building out our platform and capabilities, that should be achievable within the next five years. This is not to say that we will stop acquiring new customers. We continue to do, particularly on referrals from our corporate customers and business owners in CMB that continue to come through to us, and we added 100,000 in the first quarter of this year. But our intent is to be much more balanced and not just chase volume of customers for volume's sake. We have to work with those customers to ensure we are fulfilling all of their requirements. Turning to our Retail Banking business. I need to set out up front that our Retail Banking business is important. It continues to provide us with a good source of earnings. As you have seen from the slides before, we continue to be able to attract deposits, to attract customers. We continue to be able to provide lending solutions to our customers around the world, and we see the ability and the potential to grow our earnings out of the Retail Banking businesses in markets where we have got the scale and presence to be able to do so effectively. It has to be said, however, that trying to run Retail Banking businesses across multiple markets can be very expensive. The Retail Banking business does give us a number of opportunities. It does enable us to acquire customers; unlike a typical stand alone wealth manager, we can share the cost of customer acquisition and distribution across our Retail Banking and customer activities.

But if you manage those businesses as a federation of individual businesses then you tend to suffer from significant diversity or products, of process and services, market by market, with the associated complexity that brings. The management overhead that comes along were trying to do that. Whilst we have centralised some of our processing into centres of excellence, the reality is it is very hard to get real operational efficiency if you have still got 61 variants of every product, 61 ways of doing everything that you do. So we are going to move to a global management model where we will enforce standardised propositions across the group, standardised products and processing and platforms to ensure that we cut out some of that variation. This will enable us to properly streamline our businesses, cut out some of the management overhead and complexity and reduce the cost in each country through leveraging shared platforms.

As Sean has indicated, there are not any silver bullets to re-engineering, it's a process of taking process by process, finding the best practice across the Group, and looking at external benchmarks, and then re-engineering the one way we will do this across the group process by process. But there is no need whatsoever for us to have credit analytics people in every single market we operate. We can do that far more effectively centrally where we can employ the talent and have the ability to be able to manage and get expertise and learning across markets. Where we have done this before it has been very effective. Right through the midst of the financial crisis around the world we were centralising our collections capabilities, which meant changing our management models for collections, putting in new platforms, new systems, and that has had a really strong impact on the way that we collect and the way that we manage our loans. But we have to start with all of these things from the principle and the discipline of a single strategy and a set of common standards across the Group.

Finally, Portfolio Management. We will focus our capital and resources where we can build businesses with attractive returns. Building scale in attractive markets, focusing on core segments and populations and building out our Wealth Management capabilities to provide the non fund income that will complement the earnings from our Retail Bank beyond pure balance sheet growth. Where we have businesses that are subscale or underperforming we'll re-engineer and standardise them. And where we cannot do that cost effectively and we cannot see a path to scale, then we will consider whether to exit those businesses. Now those could be whole retail businesses in a market like the retail business in Russia, but it could include individual businesses like the AFORE business in Mexico that we exited recently. But every single business we have will be looked at in the context of the five filter review to determine is there a reasonable path to profitability.

This is not a strategy that says to you, 'We need to spend lots more money in the next few years on the basis we will get longer term returns.' This is a strategy that says, 'We will re-engineer what we spend today to enable us to drive up revenues and generate new returns.' IT is an example. We are going to focus our IT spend on business strategy, on supporting re-engineering, building Wealth Management platforms and driving SDP. But I don't expect to spend any more on IT in the future years than we have been doing in the past. We will make savings by not spending a lot of IT, producing a dozen different variants every time we have a product launch. So we will change the nature of our spend, not increase it.

Critically, as we build our businesses, we will work in an integrated fashion across the retail business with insurance and asset management. And at that point let me hand over, first of all, to David Fried, who will talk to you about our insurance business.

David Fried, Group Head of Insurance

Thank you, Paul, and good afternoon. First of all, let me start by saying that Insurance is a core part of the Retail Banking and Wealth Management strategy at HSBC. At present Insurance operates in 54 countries globally. In 22 of those countries, where we manufacture insurance, we are able to integrate and align our manufacturing and distribution capabilities in order that we can create tailor-made solutions to meet our customers' needs. HSBC is one of the world's leading bank assurers. In 2010 Insurance, excluding our associates and the sale of our insurance broking business, contributed $2.6 billion in profit. Retail banking and Wealth Management contributed 92%, or $2.3 billion of that. But also with our focus on faster growth markets, Asia and Latin America contributed 67%. And with the attention that we have been paying to the demographic change opportunities that Paul has just mentioned, life pensions and investments represented 60% of our profits.

Bank assurance is the fastest growing market for insurance globally. You will find that most major insurers are seeking alliances with banks in order to get access to their customer base. Our strength is our access to our 92 million customers, and our ability to align our manufacturing and distribution to capture the full value chain. And what I mean by that is that we don't just take a distribution commission. We also receive underwriting profit, we have embedded value investment income, but also the HSBC Group as a whole benefits by the fact that we retain asset management fees and global market fees. And because of the fact that we are life pensions and investment focused, we are able to retain an annuity stream of income going forward.

As we look forward, our priorities are going to be to continue to focus on the opportunities presented by the changing economics and demographics and growth markets. And from this, the growing needs for protection, wealth transfer and pension products, we will continue to focus on increasing cross-sell and penetration into our existing Retail Banking and Wealth Management customer base by developing globalised suitable high net worth propositions that our bankers can fit straight into the Retail Banking and Wealth Management propositions. In some of our mature markets we'll refocus the way that we do business. In the UK, for example, we are principally a protection business. In the future we will provide more long term savings and pension products, especially those as they relate in the changes in corporate pension legislation.

In France, where we are historically a savings business, we will provide more protection products, and this will be our attempt to help narrow the €1 trillion protection gap that is said to exist in France today. However, this isn't just a Retail Banking and Wealth Management story. There is a significant amount of opportunity that is untapped in our Commercial Banking and Global Banking customer bases, and here we will work with our preferred strategic partners. These are companies like AXA, Alliance, Aviva and MetLife. But at the same time we will work with our preferred strategic broker, Marsh & McLennan, who we sold our insurance broking business to in order to ensure that we had the right solutions to meet these customer needs. But through all of this we will continue to enhance our focus on bank assurance. In the 14 months since I took responsibility for insurance globally, we have developed very strict portfolio reviews, and through this we have divested our insurance broking business, our captive management business, the Chilean pension business, the Mexican AFORE business, and we have put our UK motor insure and our Irish reinsurance company into run-off. All of this has occurred because these businesses were not aligned to our integrated bank assurance model.

In conclusion, I believe that the insurance business is connected to the bank structure and to our strategies for the future, and we are ready to absolutely take advantage of all of the opportunities that will present themselves in the ever changing world that we live in. And with that, I want to hand over to John Flint, the Chief Executive of HSBC Global Asset Management.

John Flint, Chief Executive, HSBC Global Asset Management

David, thank you very much. Ladies and gentlemen, good afternoon, and for those of you who I haven't had the privilege to meet yet, I am John Flint. And I am going to introduce the asset management division of HSBC to you this afternoon. I'm going to start with a statement of the obvious. We are not an independent asset manager. The reality that we are the asset management division of HSBC speaks very directly to the strategy that I will outline shortly after introducing the business to you.

In our current form we have 400 investment professionals in 19 countries managing $439 billion for our clients. All clients of the Group, and all customer groups represented, so we manage money from the man in the street to the sovereign wealth funds and the world central banks. At present the majority of the money that we manage is managed on behalf of institutional clients. The most demanding client segment, it's important to notice this, most of the money we manage is for the most demanding client set. Our business is diversified by asset class, by geography. It's profitable, it was profitable throughout the financial crisis, it enjoys efficiency metrics which are good by industry standards, and we enjoy a position of considerable strength in Continental Europe, the origins of which came through the acquisition of CCF, and in emerging markets, where we are already one of the world's leading asset managers of emerging market assets.

In our current form, therefore, the platform was built, it is scalable, it is robust. Let's talk about what the strategy is. And the business strategy is very simple. We are going to build on the existing platform and build the business around two very compelling opportunities. The first opportunity is the opportunity that exists with asset management now as part of Retail Banking and Wealth Management, the opportunity to meet the needs of our retail clients. We are not an independent. Remember, we come to work every day with 90 million customers who already trust us. They're signed up, we are ready to do business with them. Our challenge therefore is to deliver products and services that help them meet their long term savings and investment needs. Now the arguments around longevity, the arguments around the state of government finances, etc, will be referenced in many presentations today. They are well rehearsed.

Paul indicated very clearly our current penetration rates with our existing customers are low by industry standards. So the first significant opportunity is to address that. And as we address that, what you should expect to see is we will continue to develop our asset allocation products for retail clients. Recognising that for retail clients perhaps the biggest lever that we can help them pull is the extent to which they are invested at all, and if so in which markets. Consider that as opposed to pure stock picking, which many of you are here to do. Asset allocation is going to be one of the key services for our Retail Banking and Wealth customers. You will be familiar with the World Selection product, and that is one very good example of the types of products and services that we will deliver into Retail Banking and Wealth Management.
The second opportunity that we hope you will find compelling as well is to continue to develop our emerging markets business. And our emerging markets business needs to be thought of in two distinct pieces. The first is the offshore piece, facilitating the flow of money from the old world into the new world. Returns are not good in the developed markets right now. Increasingly we are seeing portfolio allocations grow as people allocate funds into the new market. Our competitors in this space are the other global asset managers. And it is a very competitive space. One of the reasons why we are excited about this is at present our single country product is stronger and often larger than our regional or global product. So once we have made the necessary amendments to the regional and global product, we think we can look forward to significant growth in the offshore piece.

The second piece of our emerging markets business is the domestic piece, the business that serves the needs of domestic clients. Meeting developing investment product for domestic consumption in the high growth economies, Brazil, India, China, Turkey, Hong Kong, etc. And there the global asset managers do not compete with us because they don't have the on the ground presence. In our domestic businesses we have access, again, to the client base that trusts the brand, the emergent middle class with a high propensity to save, so the opportunity is clear.

So in summary therefore, we have a platform which is scalable and robust, and we have two clear opportunities that we will build the business around. If we are able to change the share of investment wallet with our existing client base, if we go from our existing levels to market norms, the P&L of asset management will roughly double. And the emerging market asset management business that we already enjoy, which is growing significantly, has the potential for much further growth, given the trends that you will have heard about during the course of today.

I will hand back to Paul. Thank you.

Paul Thurston, Chief Executive Retail Banking and Wealth Management

Just a couple of final comments to wrap up this section on Retail Banking and Wealth. I hope you have seen this afternoon that we are committed to real change in our retail business in the years ahead. We see real opportunities in Wealth Management, but we also see real opportunities to improve our Retail Banking business. Doing both will enable us to improve our returns, and we are targeting to be in the range of 2% to 3% within the next three years. I should just reiterate that this continues to include some drag effect from the continued residual run-off portfolio in the United States. And on that note I will now hand over to Chris Meares, to talk about private banking.

HSBC 2011 Investor Day

Global Private Banking

Presentation by
Chris Meares, Head of Global Private Banking

11 May 2011

Thank you, Paul. Good afternoon, ladies and gentlemen. I am the Chief Executive of Global Private Banking, and I am now based in Hong Kong. And I think you should see this as a good guide of what HSBC can achieve in Wealth Management if we really put our mind and management to it. I am going to explain some of the key trends that are happening in the industry, and why despite some challenges, it is still a very attractive business. But first of all I am just going to introduce what really matters in private banking, and HSBC's strong position.

So 12 years ago HSBC was nowhere in private banking. And what we needed to be and what we needed to have to be a leading international private bank was three key things. Firstly, an established footprint in the key Wealth Management centres in the world, and also to start building up a presence in the fastest growing wealth markets in the world. That is what we have been able to do, so we have got units of real scale in the key Wealth Management centres, and in the last five years we have built up domestic private banking units in the key markets where we can see that there is a huge population and huge wealth creation, Brazil, Mexico, Turkey, Middle East, India and China. A lot of these are still in the early stage, but this is a long term game.

The second thing that you need in this industry is a strong brand and an efficient platform to offer and provide a very complex set of services. This is anything from derivatives through discretionary management to advisory and trust and estate planning. A series of acquisitions about 10 years ago provided that platform, and with collaboration with the units on the ground we were able to go into many of the other countries working with the HSBC Unit, who provide the back office and middle office in many of the new countries. The brand and the ratings have allowed us to build one of the largest private banking businesses in the world with almost $500 billion of total client assets.

But the third thing that you need is to have a resilient and sustainable business model. After the financial crisis, all the private banks saw revenues decline. We saw client risk appetite go very risk averse, so trading was down. We saw interest rates collapse to historically low rates, and they are still there. So what you needed to do was adjust your business. We reduced costs, and only through investment last year they got back up to 2007 levels. But also, as clients shifted out of equities and fixed income into cash, we were able to pick up the margin on the cash side. Then when they switched out of cash into fixed income we were able to pick up that business as well. So you have to have an adaptable business, and you also have to have diversified earnings and not be dependent on any one market and any one region around the world.

So cost, as you heard earlier on from Stuart, this is a high cost income business. And actually 66%, it went up from 60%. But 66% is still competitive by industry standards. However, the good bit about the business is it is not capital intensive. And you have heard earlier on that the return on risk weighted assets is attractive, and over the last five years we have been able to generate profits in excess of $1 billion, generating surplus capital. The other nice attribute of this business is it has very strong liquidity, so we have over $100 billion of deposits, and an A/D ratio of 38%.

But what's actually happening in the industry at the moment? I think you have heard in the earlier presentations this morning, but just to remind you, that the fastest wealth creation in the world happening right now is in Asia and the other emerging markets like the Middle East and Latin America. And combined, those markets will be the same as the Europe and America market in terms of high net worth wealth in 2013. Who in this room 10 years ago would have thought that three of the four largest IPO markets in the world would have been in Greater China? Hong Kong, Shanghai and Shenzhen. It just is an illustration of the wealth being created in that part of the world, and surplus wealth to be managed. In our business we already see 50% of our clients' assets come from those faster growing markets, those emerging markets. Most of our hiring is focused on servicing those markets, both in the developed markets and in the emerging side. And in the last two years the vast majority of our net new money has actually come from those markets.

The second trend, which some of us don't always focus on, is there is a massive intergenerational transfer of wealth taking place. This is the post war generation of entrepreneurs who sprung up not just in Asia and in the Middle East and Latin America, but also in many other countries. If you look at the *Forbes* Magazine, most of these billionaires are well over 55. Many of them are still involved in the business, many of them have quite complicated requirements. They have to think about how do they manage succession not only in their business, but how do they manage succession for families? How do they hand on wealth? Is it a good thing to give it to the next generation, and so on. We have one of the largest and strongest trust and estate planning capabilities in the world, with over 164 billion assets under administration, and 800 people serving that business. Actually two thirds of it is in Asia, and we have been in this business for a long time in Asia. And it's a critical cornerstone of a lot of the business that we do with our very wealthy families. Family governance and helping them plan for the future. And why do they like to use us? Because they want a brand and a bank that's strong because it's going to be a trustee just for them, but the many generations coming on. If you have a trust relationship it usually extends the banking relationship with that family for many more generations.

And the third thing, which is probably more about the challenges that we face rather than the opportunities, is firstly the regulatory development. Actually the private bank industry is in very good shape to meet the sort of new Basel III world of higher capital requirement and liquidity requirement. But there's lots of work and lots of regulation coming out in terms of the whole area of sales suitability and cross-border marketing. So all private banks, and ourselves included, are upgrading our systems and operating models, and having to invest to deal with that. And of course you see a lot of the other private banks also realising that they have to develop their domestic footprint. And that isn't easy. Many of them don't have the scale in these countries to build on, whereas HSBC does, and we have been able to build those units, those new units because HSBC's present in the countries that we need to be in. On the other hand also, there is pressure on our margins. Because of low interest rates this is a very liquid business, as you heard from Stuart early on. What do you do with that liquidity and how do you deploy that to make money? In addition to that, client risk appetite, as you all can see, has improved a bit, but it's still to prone to risk on, risk off phases. And what do you have to do to handle that is to have very good advisory – we have a global investment committee that continues to adapt the investment advice and investment offering to our customers.

The third bit of pressure on our margins, without a doubt, is because everybody wants to be in private banking in Asia, and other countries. And so you see a lot of people hiring. And in places like China, money is new. There actually aren't any private bankers there, and we have to grow and train our talent in those places. So there is a challenge there, and there is also a local challenge in Switzerland with the strong Swiss franc at the moment. So in response to that, you obviously have to continue to manage the cost base. For example, in Geneva we had 13 premises from two banks that we have merged, and we are getting that down to three. That's a long term saving, which in the meantime has some costs attached to it. So you have to keep adapting to those challenges.

I am just going to quickly set out the four strategic directions that we are taking in this business. Firstly, actually it's quite hard to find acquisitions. It is quite tricky and they are very expensive in the markets that you want to make any acquisitions. So the focus is on organic growth, and that mainly has to be through adding relationship managers. We have a target of 150 new relationship managers every year, and that's about 5% of your front office that we're looking to add each year, focused on the growing market. It's also about how do we deliver emerging market product to our developed markets. Many of our customers, many of you in this room would quite like to know how to invest in all the emerging trends that are going to affect your life, and that's our job to sort of take that to it. The second strategic driver is very much levering the intergroup strength, and I am going to spend a little bit more time on one slide on that. The third piece is that we genuinely believe that we can grow the annuity revenues in this business, and that's because the current percentage of assets of our clients that are actually in discretionary and advisory mandate is still lower than we would like it to be. And there is a real opportunity, and I will go into how we are doing that. And the fourth point is just you have to keep investing in the systems, so we have a rolling three-year programme of improving our front end systems across the world, very much using the strengths that we have in Asia where we have a great platform already.

Delving into the second strategic action, which was about how do we leverage the intergroup piece. I will just give you three great examples here. We have been having a programme of intergroup referrals between all the businesses for the last five years. We have raised $26 billion of net new money from intergroup referrals, from Retail Banking, Wealth Management, Commercial Banking and the Global Banking and Markets. If you imagine that we have got a Retail bank and Wealth Management business, if you imagine that we have 4.4 million Premier customers, many of those will eventually become wealthy, and we have a very good referral programme for seeing those who come into the private bank.

CMB, as you have heard, is the sweet spot for this bank, and within their customer base there are a huge number of owner managers who eventually will be successful and have a liquidity event, and we work very closely with Commercial Banking to try and capture those opportunities. And then with Global Banking and Markets we have created a family office partnership, and I'll talk a little bit about that. But I think it's worth also noting that over 80% of the volumes that we trade whilst we still meet best execution go through Global Banking and Markets. That's a huge amount of volume every year.

Just going on to the second point, about annuity revenues and how we develop the investment services, and how we're growing that. I'll give you some examples on this slide. The first bit is about providing specialist emerging market foreign exchange advisory. As you are going to hear later on, HSBC's a leader in offshore Renminbi. This has already allowed us to build up a programme, and from those deposits are now going into Renminbi deposits of over $2 billion for our clients. We have been able to establish an emerging market programme, with asset management helping us, and that has raised $1.3 billion in terms of emerging market fixed income investments in our Swiss business. That gives you an idea on the emerging market foreign exchange side. We also have a unit that's called Corporate Finance Solutions. This is helping our private clients when they have some business needs. We facilitate that and work with Global Banking and Markets. At any one time there will be a pipeline of about 30 deals where customers are looking to sell a retail business, have a bond issue for their business, or just look for a cross-border opportunity. We act as the glue between the client, in many cases, and Global Banking and Markets. Just to give you an idea of that, HSBC has a great reputation now in the research side of the whole area of climate change and renewable energy, and a couple of examples just the year are where some of Middle East clients acted as cornerstone investors in a clean energy venture, and also where Global Banking and Markets did a wind power bond issue for one of our private banking clients who owned the business.

Finally just another example is that we are one of the leaders in the fund of hedge fund business. On the back of that alternative business we have been able to develop specialist private equity and real estate advisory. So this is where we seek out special opportunities for our clients, in the Middle East for example, seeking to invest in Asia or seeking to invest in New York or the UK. It's a very powerful cross-border solution for our clients.

So just to wrap up, I think we have three key competitive advantages. We have already an established footprint; we don't need to grow the footprint. It's about building on what we have got. We have got a strong brand and a very efficient platform now to deliver those services, and we have got a resilient and sustainable business. The strategic actions you heard just now are very much about growing our domestic business, and also making sure that we absolutely take advantage of those fast growing markets. It's about leveraging the intergroup strengths and growing our annuity revenues, and obviously controlling our costs whilst also investing in the platform. And because of that, we believe we can still produce a return on risk weighted assets in the range of 4.2% to 4.8%. Thanks very much. I'm now going to ask Stuart to come up and chair the questions for us. Thank you.

HSBC 2011 Investor Day

Customer Groups – Part Two

Questions & Answers

11 May 2011

Stuart Gulliver, Group Chief Executive

Thanks very much. Just one thing to slightly embarrass Paul. Paul was running Retail Banking in Hong Kong when I was running the trading room in 96/97. And in Hong Kong at that point in time most of the profitability of our Retail Banking business came from mortgage lending. Mortgages were priced basically at best lending rate plus whatever number you wanted to add to it. And then in essence they got re-priced off HIBOR, and the margins collapsed. And what Paul did was completely reposition our business, which really was massively dependent on mortgage lending, into a Wealth Management business, and then in fact created the foundations which have been subsequently built upon to today's Retail Banking and Wealth Management business in Hong Kong, which is the good norm which we will put in place in other places. He also actually was responsible for starting the journey here in the UK with our retail bank in the UK, which Brian will talk a little bit about, and has now passed the baton to Joe Garner, to also reposition our retail bank here into going more upmarket and into Wealth Management services. So the reason I appointed Paul is he actually has a track record of executing this, a prior, proven track record of executing this within HSBC.

Anyway, we have got a bit of time for questions before we break, and then the next block will be on the Geographies. But questions on Retail Banking, Wealth Management and Private Banking, please, just here if we can. Thank you.

Rohith Chandra-Rajan, BarCap

Thanks. Afternoon, it's Rohith Chandra-Rajan from BarCap. Just a question again on the return on risk weighted assets. The sort of 1% to 2% to 3% looks, of the business lines, is obviously the biggest challenge. It looks like perhaps the removal of the drag from the North America business might improve that by maybe 60 to 70 basis points, so I wonder if you could confirm that is the right sort of ball park. And then what your expectations really are for the improvement from Wealth Management and also efficiency gains and anything else that you care to mention.

Stuart Gulliver, Group Chief Executive

Paul, do you want to kick off on that? We have indicated in Paul's presentation a $4 billion revenue add over the next 3 to 5 years from Wealth Management, and you're right that the US business is a significant drag on those returns on risk weighted assets that runs down. Paul.

Paul Thurston, Chief Executive Retail Banking and Wealth Management

But the reality is that there's a number of moving parts in this. There's probably more change happening here than anywhere else in the business, and you have the different effects of certainly the continued run down of the drag coming through from the household consumer finance business. You have the progressive re-engineering of some of the Retail Banking businesses. You have the build of some continued Retail Banking earnings, and you have a growth in Wealth Management. All of those will happen at different paces over different times. I would expect the return on risk weighted assets to progressively improve. But that picture we have given of 2% to 3% is actually not an end state position once you have actually completed the run off. So there is room for progressive improvement thereafter, but I don't think we're breaking that down into the component parts today.

Rohith Chandra-Rajan, BarCap

I meant on the mix between those different drivers.

Stuart Gulliver, Group Chief Executive

It's a very complicated picture, as Paul has just tried to set out, because you have got a bunch of run-off businesses, a significant re-engineering programme in Retail Banking, and the build out of a new initiative in Wealth Management. And so it wouldn't be reasonable at this point in time to dive under those numbers. You have to just bear with us, and as we go to quarterly updates we will give you more specificity on it.

Rohith Chandra-Rajan, BarCap

And could I ask one more just on the Wealth Management revenue, the $4 billion uplift. The implication seems to be a doubling or more of assets under management. I just wondered to what extent that is a transfer away from your deposit base and into more investment business, and how much is winning that from competitors, and how you see the competitor landscape.

Paul Thurston, Chief Executive Retail Banking and Wealth Management

I think that our experience has been so far, where we have done this successfully in individual markets, that the majority of the growth actually comes externally because we weren't attracting the kind of Wealth Management products and services because we weren't delivering them as effectively as some other people. So most of that comes new, we haven't lost significant amounts of deposits as customers have continued to do more investment, more insurance business with us.

Michael Helsby, Merrill Lynch

Thank you Sir., Michael Helsby from Merrill Lynch. Just a question on risk appetite within Retail. Clearly you have got your risk appetite back in Asia. You've always historically been very cautious on the UK, so I was just wondering if you could give us an update on how you see the UK at the moment in terms of credit, and if you could give us your perspective on that, and what your risk appetite is like in the UK, particularly in the mortgage market where I know that you do continue to do very, very low LTV lending. It looks like there is a big opportunity there if you're willing to move up the risk curve just a little bit.

Stuart Gulliver, Group Chief Executive

Well let me start off, and then actually Paul can continue, and Brian can probably continue later on as well on this. We have made a bit of a virtue out of being quite cautious in the UK, as you know. We took our foot off the gas at the end of 2006, and that protected us somewhat from some of the worse excesses that happened to some of our competitors. And we didn't originate mortgages through brokers, and we continue basically to be involved in mortgage lending to our customers. We still don't use brokers. And the average LTV in the book is still about 57. But we have increased our market share, and I think our share of new draw downs is about 9%. So we are lending, we are gaining market share, but we're gaining market share in a specific segment that we're comfortable with, and that as I say, results in an overall portfolio with about a 57% LTV.

Paul Thurston, Chief Executive Retail Banking and Wealth Management

I don't have much to add to that really other than the fact that we do do higher LTV lending. We do quite a bit of that for our Premier customers, but if you take the total overall, the average still remains pretty low.

Stuart Gulliver, Group Chief Executive

Yes, your next door neighbour.

Alistair Scarff, Merrill Lynch

Looking at your future number of retail customers, how many of those would you put into the potential bucket of upgrading to the Premier class? And where I'm leading to this is that if you're taking the filtering approach of where you're seeing sub-centre businesses and managing them away, what proportion of that 92 would maybe fit in the substandard and hence no longer attractive market bucket?

Paul Thurston, Chief Executive Retail Banking and Wealth Management

I guess the biggest portions of those would actually be in the US through the cards business and through the consumer lending business. So that's where the large numbers come from. We have a portfolio of Premier customers of just over 4 million today. We have a portfolio of advanced customers of 4.6 million, which we built up very, very rapidly. So it's those sorts of orders of magnitude that advanced has already been proven to be a rich source of upgrades for Premier. And that's where we really go for the Premier business, coming through the advanced base. And we continue to advance as we build it out in each market. But you wouldn't say that the whole 92 million customer base are all potential Premier customers, they're quite a long way from that.

Alistair Scarff, Merrill Lynch

Obviously, but if you're looking from a product perspective, I'm just trying to get some sense as to where the real flex points are. What proportion of that 92 would typically have more than one product, for example?

Paul Thurston, Chief Executive Retail Banking and Wealth Management

It varies significantly today from countries to countries. In some of the countries we have relatively large credit card portfolios, and in a number of them they have not been the kinds of customers that you would probably want to convert to product ownership. In the past, attempts at building out product ownerships with credit cards have got you into products like credit and protection insurance and things like that. In some of the emerging markets, however, we have been able successfully to attract new customers, initially with credit cards, and then start to build Premier out of that. So there is potential in some of those markets to use the credit card as a customer recruitment tool, which you can then build and mine for further customers.

Manus Costello, Autonomous Research

Hi, it's Manus Costello from Autonomous Research. You talked about deposit margin competition continuing. I wondered if you could just give us an indication, going into 2011, how much additional deposit margin pressure there is still to come from the interest rate environment, regardless of competition, most of which I think would be outside of Hong Kong. If you could give us a dollar amount of headwind which you're facing? And secondly, for the plan for the Group as a whole, can you give us an indication of what Fed Funds assumption you're assuming over the course of the next couple of years? When are we expecting the first rise in rates?

Stuart Gulliver, Group Chief Executive

Okay. I think deposit margin compression coming from interest rates has probably bottomed out actually in most markets. I don't think we see rates going any lower in any particular market. Where we will see further deposit compression is in places like the UK, as banks have A/D ratios significantly higher than our own wean themselves off the special liquidity scheme of the Bank of England, or migrate to some form of term repo facility with the Bank of England. And assuming that that is priced in an aggressive way to encourage them to raise retail deposit will cause a margin squeeze there. So that is very much a UK specific thing, and when therefore Paul says even if rates go back up in the UK, the deposit spread we enjoyed prior to the financial crisis won't re-establish itself, that's what we are referring to there. But in terms of the overall interest rate cycle, the euro rates are already going back up, and a number of the rates in the Asian markets have already gone back up because of inflationary pressure. And so it kind of leaves essentially a view on when UK rates will go up, US dollar rates and therefore Hong Kong dollar rates, and I will ask Samir, because I'm clearly not involved in this any more.

Can we get a microphone to Samir? Thank you.

Samir Assaf, Chief Executive Officer, Global Banking and Markets

So our clear view is that interest rates in Europe would go up to 2% between now and the end of the year. The UK rates and the US rates will stay flat for a certain period of time, at least this year, and emerging market rates will continue to go up. So the imbalance for our business is for this part of the globe, UK, US and Hong Kong, we will continue to have the same kind of returns, but the rest of the globe actually, whether it's in the deposit side of our business or in the custody GTB side of our business. And even if the rate normalised at the right yield curve, actually even in BSM we can get some pick up in the business.

Stuart Gulliver, Group Chief Executive

Thanks, Samir. Shall we switch to the other side of the room. Perhaps Simon Samuels first, gentleman with the green tie.

Simon Samuels, Barcap

Yes, thank you. Floral tie, actually.[Laughter]

Stuart Gulliver, Group Chief Executive

A very marvellous tie.

Simon Samuels, Barcap

Thank you. It's slide 105, so Paul's presentation. It's the one that basically – sorry, not 105, apologies. The one that – yes, 105. It's the one that shows that you're loss making in about half the countries that Retail Banking is in. And can you give us something more about that? I mean have they always been loss making? Is it one big country is loss making, the others are profit making? What's going to happen? How much capital is deployed there? Can you give some colour around the fact that you're loss making, it looks like, in half the places you're operating at the moment in Retail Banking, and basically what's going to happen there.

Stuart Gulliver, Group Chief Executive

Well you can see why I made the comments I made at the very beginning of the day. It's not one big country. If you're talking about the others, the 39 markets, it's very simply this. It is the case that in Retail Banking it is a scale business. So therefore to get reasonable profits you need to have reasonable scale. So therefore we have got scale in the UK and Hong Kong, and we have got scale in places like Malta, Bermuda, Brunei and Panama. We believe that we've got sufficient scale and the sufficient growth to continue to invest in Brazil, Mexico, Singapore, Turkey, Egypt. But in the other countries it's very hard work. And it's back to actually some remarks I made to the press. What we also historically have tended to do is build every country as a copy of Hong Kong. So every country is just a smaller version of what we do in Hong Kong. So you open in a country and you have to have Retail Banking, you have to have some credit cards, mortgages, Commercial Banking, Global Banking and Markets, the same signage, etc. And actually what we need to do is build a series of businesses that are not homogenous because actually our presence in countries isn't homogenous, but it's actually heterogeneous.

And that's what we did with Global Banking and Markets. There are 67 odd dealing rooms and they're all different from one another because our market presence in the countries is all different from one another. That doesn't mean you can't have the same systems and the same product propositions either, so don't confuse that with an inefficiency consequence. But actually, of those 39 countries, they have been this way for quite some time. And that's why we're taking the action that we are taking. Now again, if the next question is, 'Well why don't you fix it before?' we have been managing through quite a major financial crisis, and these aren't necessarily ones that were a bigger issue than the one right at the bottom, which obviously is the US and Household. But you might want to add a little bit of colour there, Paul, on it.

Now to be clear as well, China and India are important, and they are strategic investments. Actually India really was the consequence of trying to – actually to be very honest, it was a consequence of entering consumer finance, trying to follow the household model into India, which actually doesn't work in India either.

[Laughter]

And so India, with the purchase of the RBS branches, once the detail is complete and Naina is sitting there in the audience, we're pretty confident we'll be a profitable PFS business again, and it's a really important strategic country for us. So that one is reasonably easily fixable. The China one is an investment and a build out in branches, which is clearly of strategic importance to us. We have to build out as many branches as we are given permission to open because we need to get RMB financing. That's to get an RMB deposit base. So there's clearly a strategic reason why we would be prepared to invest through quite an extended J curve in building out our Retail Banking business in China, which is about RMB deposits.

And then on the 39 markets I'll get Paul to comment.

Paul Thurston, Chief Executive Retail Banking and Wealth Management

Just really to reinforce something I said earlier, that Retail Banking today is an expensive service to provide. In the past if you were in a country and you were running a commercial business, and the commercial business owner said, 'Will you provide some banking accounts for us?' we could do that. Simple branch, simple checking accounts service, no problem. Today to run a Retail Banking business when you've got to have access to clearing systems, credit card systems, ATM networks, internet banking, call centres, mobile telephone, it's a very expensive infrastructure you have to put in place to run a retail bank today. And if you've only got a very small number of branches and a very small number of customers it's really hard to make that profitable. As Stuart said, in a number of those markets, not just India, we also embarked on trying to expand our inter-consumer finance as a way of leveraging off. The infrastructure was there, we built out a consumer loan portfolio in a number of those to go beyond the reach of the branches. But that has not been successful. We are pulling back from that. If that leaves you with a small number of branches and a very expensive solution, then you have to do something about that.

Stuart Gulliver, Group Chief Executive

Thank you. I'd like to take one call that we have queued on the system. So operator, can we take the call from Hong Kong, please?

Tracy Yu, Deutsche Bank

Thank you. My question is a follow up question on Retail Banking strategy, but more focused on the rest of Asia. While I think we agree Asia is clearly the source of growth, however I think some Retail Banking markets are still relatively sub-skilled with high cost to income ratios, such as Taiwan. Does that mean that HSBC will prefer further investment in this market while they're restructuring, or exit? And can you comment on the overall strategy for this market, and use some examples to illustrate your thinking process for the change. Thank you.

Stuart Gulliver, Group Chief Executive

Well the thinking process, Tracey, is the five filters analysis. And again, we're going to resist giving a list of countries. What I would say though is Greater China is of massive strategic importance to us. So Taiwan clearly needs to be restructured as opposed to exited.

We'll take a question from the room. Yes, Ian. Sorry, I didn't see you had the microphone.

Ian Smillie, RBS

Thanks. Ian Smilie from RBS. Two questions, please. Firstly, could you offer the same colour on what you think happens to Hong Kong deposit margins as and when US rates at the short end eventually start rising? And secondly, for your major loan book exposures, could you give us a sense of the absolute level of interest rates when you start to worry a bit more about asset quality again.

Stuart Gulliver, Group Chief Executive

I think that interest rates have to go up quite a long way to worry about asset quality. And I would include here even mortgages in the UK because of the very defensive LTV we have. The market that in our view is most exposed to rising interest rates is the UK because of variable rate mortgages. And obviously one of the benefits of interest rates going as low as they did, and this is why you haven't seen high street retail sales drop, is effectively there was a windfall effect into people's available money. As interest rates go back up here that will go into reverse, so therefore there is a risk as the UK raises rates that you get a worsening of credit quality for the banks that have done mortgage lending here.

But to stress, our book has an LTV of 57, so we don't see that as being a risk to us. So I think that rates can go back quite a long way before simply higher rates cause us to have particular concerns about credit risk. And in Hong Kong we have a very, very, very competitive A/D ratio, and a very low A/D ratio in Hong Kong. And the Hong Kong market actually doesn't have the structural situation the UK market has. The UK market clearly at this moment in time has less deposits than loans as a system. That isn't the case in the Hong Kong market, so therefore the deposit margin squeeze, which we can foresee happening here in the UK because of SLS run off, etc, they are all idiosyncratic facts that apply to the UK only. And therefore one wouldn't expect to see that.

The Hong Kong challenge is inflation, and wage price inflation coming through the expense line rather than deposit margin compression coming through the revenue line.

Ian Smillie, RBS

So just to make sure I've understood you there correctly, Stuart. As and when US rates start rising we should expect the Hong Kong deposit margins to come back in your favour?

Stuart Gulliver, Group Chief Executive

Yes.

Ian Smillie, RBS

Thank you.

Stuart Gulliver, Group Chief Executive

Yes, please.

Anil Agarwal, Morgan Stanley

I just have a question on Hong Kong risk weights. So mortgage risk weights in Hong Kong are less than 10%, 7%, if I'm not wrong. Now that HKMA has reduced LTVs to 50% and property prices are still rising, is there any chance that they start tinkering with the risk weights on mortgages? And how does that affect HSBC, because a lot of banks in

Hong Kong are still on the standardised approach of applying 35% risk weight. So does it change our RWA?

Stuart Gulliver, Group Chief Executive

Again, I'm actually going to ask Peter. Can we get a microphone to Peter? Peter, just wait for the mike. Oh, you're miked, but you're not live. Thank you.

Peter Wong, Chief Executive Asia

There is no indication from the HKMA that there is going to be a change on the risk weights on the mortgages. So we don't anticipate that there's any change at this point in time.

Anil Agarwal, Morgan Stanley

Can I just have a follow up question?

Stuart Gulliver, Group Chief Executive

Yes, of course.

Anil Agarwal, Morgan Stanley

Assuming property prices start coming up in Hong Kong, obviously asset quality is fine given their LTVs but most of the collateral against loans, be it mortgage or corporate or whatever, loans or property, how does that affect their LGD assumptions and hence risk weights, because again, risk weights in Hong Kong are 25%.

Stuart Gulliver, Group Chief Executive

It may have an impact in pushing risk rates higher as LGD assumptions change. But bear in mind that the historical data that would go into the model in Hong Kong will include all the previous significant movements in Hong Kong property prices, of which there are many in my 32 year working life. And what tends to happen is, provided employment stays high, the default rate is extremely low. So even in 2003, which was the height of SARS, when property prices fell significantly in Hong Kong, the bad debt experience was extraordinarily low, and the number of repossessions was literally in 10 or 15 properties type of level. So it is quite a different property market because of the way the banks are supervised, and because basically Hong Kong operates with not full employment, but actually quite close to full meaningful employment. It would not have the same impact as a US property sell off by any way, shape or form.

Anil Agarwal, Morgan Stanley

Thank you. Just to labour the point, I mean because a lot of corporate loans in Hong Kong also are backed by property, so even there you think the risk weights will not move much? Not just the mortgages, even the corporate loans backed by property if property collateral values drop.

Stuart Gulliver, Group Chief Executive

I mean there will undoubtedly be some pressure, but I don't think it will be that pronounced as to make a significant reduction in return on risk weighted assets of our Hong Kong business, which is kind of what you're asking. And then secondly, put aside what the models tell us to hold as capital, our lending in Hong Kong has always been predicated on cash flow and not on our ability to get some large A1 commercial property and sell it. So therefore even where we have taken security, we will have lent on the basis of cash flow from the business that we're lending to as opposed to on the assumption we could sell the security. And the reason why that has always been in our lending policy in Hong Kong for as long as I can remember is simply because the property market is volatile. And of course, it becomes correlated. So the day you want to sell it is of course when the entire market's down. So therefore a long, long time ago, and I think this is even in the kind of early 1980s, this is around Carrion's time, that we basically moved entirely to cash flow based, and it's great to have security as well, but not assuming that we would ever have to sell security to get repaid.

Time for one more question. Yes, please.

Philippa Rogers, Goldman Sachs

The point you made about the UK being not self-funding versus Hong Kong self-funding only works if the regulator allows you to go to 100%. My concern is obviously Norman has sounded the first firing shot in Hong Kong with respect to LDR caps. And we've obviously seen that in Korea, so I think to some extent we're seeing that coming across Asia. Your viewpoint on that, and also HSBC has been a large part of the growth in the other mainland entity lending, where obviously recourse to collateralisation is an issue, or ability to core collateral.

Stuart Gulliver, Group Chief Executive

You're right, the DSCEO letter and concerns about the pace of lending is true. But actually if you think about it, it will create possibly competition for deposits at the margin, but the very big operators there are all incredibly long on deposits, so whether it's the Bank of China or us or Hang Seng. So it's going to be in the smaller institutions, who actually have got disproportionately smaller balance sheets.

Let me explain myself better. Here in the UK we're the smallest of the four. So therefore if RBS or Lloyds suddenly have to rush to repay the SLS, that has a much greater leverage effect on the marginal deposit in the country. In Hong Kong it's the other way round. We're actually the big deposit guy, and people like the Bank of China and Hang Seng are equally big, so therefore it's not going to have that much of a massive impact on us if, and I exaggerate to make the point, the Hong Kong branch of a Malaysian Bank has to get its loan to deposit ratio under 100. So it's a fact for the system, but I don't think it's a competitive disadvantage for us.

And then in terms of the ability to – your point is ability to realise collateral in lending to mainland Chinese companies, was that the question?

Philippa Rogers, Goldman Sachs

More about the status of credit risk associated. I think was that portfolio given to Norman's focus on it?

Stuart Gulliver, Group Chief Executive

Well it's absolutely the case that for a period of time it has now been cheaper to borrow in Hong Kong for people with businesses in the mainland than to borrow in the mainland, which is a reversal, if you recall, of a phenomenon that existed for the prior two or three years, where actually mainland interest rates were lower than Hong Kong. Effectively that's reversed because the administered rates in mainland China have been taken up by People's Bank of China. But again, in terms of our lending policy, where we've lent, we've lent on the assumption that they have actually got Hong Kong dollar revenues to repay us, not that in essence they would need to sell an asset.

Where you get trapped is the classic Asian bubble which is you lend to someone to build, normally a property, again. To build a property which is a non-liquid asset, and then all of a sudden either there's an exchange rate move, the tide bar being the classic 1997 example. Or indeed the economy slows and they don't have the cash flow because they were assuming that they could sell the property or put tenants into it, etc. So again, most of our lending that's done in that way, and clearly some of the very biggest Hong Kong corporates fund themselves at the moment in that way. It's done on the assumption that they've got Hong Kong dollar cash flow to repay us from irrespective of what happens to their mainland Chinese project.

So I'm not saying for a second that risk isn't there. What I'm saying is we've mitigated to the extent that we can being exposed to that risk.

We're out of time. However, we have got Sunil Garg on the line. Can we just take Sunil?

Sunil Garg, JP Morgan

The last question was the one I wanted to ask, so thanks.

Stuart Gulliver, Group Chief Executive

Thanks very much, Sunil. Thank you. Okay, so we'll now take a 10-minute break for coffee and then we start on the Geographies, starting with North America.

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