HSBC

HSBC Holdings plc
Pre-close trading update
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PRESENTATION

Operator

Welcome to the HSBC Holdings plc pre-close trading update in respect of the year ending December 31, 2006. Today's call is being hosted by Mr. Douglas Flint, Group Finance Director, HSBC Holdings plc. Once the opening remarks have finished there will be an opportunity to ask question and answers. At this point I would like to hand over to Mr. Douglas Flint to begin his remarks. Mr. Flint?

Douglas Flint - *HSBC Holdings plc - Group FD*

Thank you very much and thank you for those who have taken the time to join us on the call, particularly those in Asia who are up late. And if there is anyone in the United States, you're up very early. Actually, also joining us, Mike Geoghegan has come back earlier than expected from an overseas trip. We didn't think he'd be back in time, so he's sitting in with me.

I don't intend to go through the statement in a great deal of detail, because I think you've had time to read what we put out earlier today. And simply to reiterate, that what that statement attempted to do was to highlight variances from the trend that you would have seen in our first half results. If I could just take may be a couple of minutes though to go through the main messages that we were seeking to draw out in the statement, and then we will take your questions on what is being disclosed. The main messages would really be as follows.

The third quarter of '06 was ahead of the prior year. On a year to date basis our underlying costs growth is in line with that which we reported in the first half and our risk adjusted revenues are ahead of that cost growth. Our growth has been strongest in Asia and in other emerging markets. And in the emerging markets that we highlighted for you at the interim results stage and, indeed, at the full year last year, we've seen the same type of growth in the third quarter as we saw in the first half.

Our CIBM business is well ahead on a year to date basis, but had a weaker quarter in the third quarter on slower trading revenues with customers, largely a seasonal factor.

In terms of issues, I think there are two things we would highlight. While it's too soon to call the top of the U.K. IVA issue and, indeed as Mike said in the conferences that he's spoken at and the meetings he's had, in the third quarter we are nervous that the U.K. and, indeed, the U.S. economy is getting to a top point and then, therefore, growth has been somewhat constrained.

Clearly when we talk about the challenges in the U.S. in the Mortgages Services business. And I think that this -- one or two remarks in preparation for that. It is a fluid situation. It's a position where historic experience is proving to be not particularly helpful in charting the future direction of some of the more recently designed products. The issues are and continue to be dominated by purchased loans in 2005 and 2006, particularly in second lien and in stated income product.

We have, since we last spoke to you, been continuing to put a huge amount of work into analytics, both from the business which is in southern of the United States, together -- from Chicago together with teams from London, and putting a great deal of additional effort into collection and account management.

Going forward we have highlighted in the statement that the model for the Mortgage Services business will change and that we will securitize a much higher proportion of the purchased loans from this date forward. And, indeed, you can see the early evidence of that in the sense that the book was flat at the end of the third quarter to that which was in place at the end of the second quarter.

I think the other thing to note is that this issue is arising at a time when our commercial and corporate credit remains extremely good. I think we've said for some time it can't continue to be as good as it is, but it does at the moment continue to be as good. And in relation to the rest of our PFS business and our Consumer Finance business in the United States, the delinquency trends continue to track more in line with historical experience and that's because of the different product nature.

In conclusion, we remain soundly capitalized, soundly -- with sound liquidity and we are well able to deal with the challenges that are in front of us, and also able to respond to the opportunities that we continue to see, particularly in the strongly growing parts of Asia.

At that point I think that's all I want to say in introduction and we would be very pleased to respond to questions. Thank you very much.

QUESTION AND ANSWER

Operator

Thank you. [OPERATOR INSTRUCTIONS]. Our first question comes through from the line of John-Paul Crutchley from Merrill Lynch. Please go ahead with your question.

John-Paul Crutchley - ***Merrill Lynch - Analyst***

Yes, good morning Douglas, morning Michael, just two quick questions if I can, the first on CIBM and the second on jaws into the second half.

The language you use on CIBM on a year to date basis showing substantial growth seems to may be suggest that the third quarter on third quarter result is actually quite a bit weaker than we saw half on half for the first half. I just wondered if you can comment in a bit more detail on CIBM in the first quarter what has been strong and am I right in that the third quarter this year is below where you were third quarter last year.

And I've got a second question on the jaws if I can come back to that afterwards.

Douglas Flint - ***HSBC Holdings plc - Group FD***

Yes, that's implicit in what we said. The trading revenues in the third quarter of this year were generally weaker than we'd seen in the average in the first half of the year. That was largely due to flow business, largely from corporate and institutional clients, less activity in July and August for all the obvious reasons. And, therefore, it was a slower quarter.

John-Paul Crutchley - ***Merrill Lynch - Analyst***

On the previous year's third quarter as well?

Douglas Flint - ***HSBC Holdings plc - Group FD***

It was reasonably flat in revenue terms against the previous year's third quarter, but the costs would be higher.

John-Paul Crutchley - ***Merrill Lynch - Analyst***

And in terms of business mix, equities versus fixed income versus derivatives, were there any particular notable movements in one or the other?

Douglas Flint - ***HSBC Holdings plc - Group FD***

No, our equities business is extremely small. The drivers of CIBM revenues are fixed income, foreign exchange and derivatives. There was no particular areas that were significantly different from others.

John-Paul Crutchley - ***Merrill Lynch - Analyst***

Okay. Secondly just on jaws as we go through and for the remainder of the second half, clearly you had big jaws in the first half. You're signaling those have narrowed a bit as you've gone into the third quarter. And I'm just wondering as we go into the fourth quarter as well where again seasonally, I suppose, revenues could be a bit more sluggish, I'm just wondering where you think the cost line will move there in terms of do you expect for -- positive jaws for the year as a whole? Or, could we see that closing up over the quarter for the remainder of the year?

Douglas Flint - ***HSBC Holdings plc - Group FD***

You're trying to make me make a forward looking statement. I don't think I'm going to get caught with that one.

I do think though that one of messages that we're getting -- seeking to get across in this trading statement is that as a result of the risk profile that we see out there we have constrained asset growth in a number of sectors. Clearly, in the United States the Mortgage Services business is not growing net business and has been one of the stronger growing parts, which is -- has of itself been an issue.

We took actions during 2005 and into 2006 to deal with the unpredictability of consumer credit in the U.K. And again, our loan growth in consumer credit in the U.K. is consciously and deliberately slower. And, therefore, there are actions taken for risk purposes that will make good growth in those businesses slower.

So, I don't think at this stage I want to predict what the fourth quarter would look like. But it's as much to do with risk appetite as it is to do with competitiveness. What happens in the trading operations is clearly a certain amount of volatility, although the exchange rate movements and so on in the last period - that tends to lead to volume and that tends to lead to value to us.

John-Paul Crutchley - ***Merrill Lynch - Analyst***

If I could just say as one final point on that, what I was trying to drive at as a question was, if it is a weaker revenue fourth quarter, have you got the appropriate levers or handles to manage the cost line appropriately to deliver an outcome you'd like for the year, in terms of your target to grow revenue faster than costs? Or, are there cost growth embedded into the business as they stand today?

Douglas Flint - ***HSBC Holdings plc - Group FD***

Well, of course, we've got levers, but I think it's very difficult to turn the ship around in a quarter. And I think you also have to say that we spent a considerable amount of time and effort building a competitive platform. And you wouldn't change the size of your platform on the basis of two or three months worth of market related revenues being a lot slower than previous months.

So, I don't think we would react to one quarter in terms of changing the scale of our platform. The scale of the platform we have in CIBM is that which broadly we are happy with. There are always things we can do at the edges and we will.

In relation to our PFS and CMB businesses, we continue to invest in these businesses largely because we see opportunities across Asia and the asset rich economies of the Middle East and Latin America. And we see much better opportunity to organically develop our businesses in emerging Europe, for example in Turkey, than at this stage looking to add through acquisition, if there were such opportunities.

So, we will continue to invest in our platforms where we can see a long term value. If that has an impact on our quarter jaws then so be it.

John-Paul Crutchley - ***Merrill Lynch - Analyst***

Okay, thank you.

Operator

Thank you. Our next question comes through from the line of John Kirk from Redburn. Please go ahead with your question.

John Kirk - ***Redburn Partners - Analyst***

Good morning everybody, a couple of questions actually. The first relates to the CIBM business. You mentioned that the performance within CIBM related to delivering emerging market product and developed market product -- sorry, developed markets continues quite well. Could you give us an idea of roughly what percentage of revenues or profits, or some guidance on how important that particular business is to CIBM?

Douglas Flint - ***HSBC Holdings plc - Group FD***

Well, I think it's very important. In terms of our geographic mix, the -- and you could see that from the interim results, yes, the Asia Pacific and South America are a very good proportion of our profitability in that business. And that's partly because of very strong payments & cash management, custody, funds administration businesses in those countries. But it's also because of leveraging our distribution platforms in New York, London, Paris, Düsseldorf to sell products originated in emerging markets. And also taking developed market product, particularly in things like structured funds, guaranteed return type product into markets that are looking for yield pick up with capital protection.

So, the mix will always be fluid and whether the profit arises in the distribution end or the product design end. But I think that the focus of our niche in CIBM is we are still clear on interest rate and foreign exchange products. And then I think our differentiation is very much our ability to leverage the developed market products into emerging markets and to take emerging market product, whether it's our BRIC funds, Indian funds, China funds and distribute these through Western markets. So, I don't want to put a percentage on it, but you can see from the interims that CIBM in Latin America and in rest of Asia Pacific was very strong.

Mike Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

Douglas, could I just add there?

Douglas Flint - ***HSBC Holdings plc - Group FD***

Sure.

Mike Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

The emphasis of emerging markets shouldn't be under-estimated. I think at the half year I said we were at the foothills of the emerging market businesses. And clearly, all of our businesses are focusing on that distribution capability that we have worldwide, which I think is unique in the financial services industry compared to others. Our footprint should allow us to distribute a lot more emerging market product and that's how we're focusing our CIBM business.

And if you see the third quarter business as being slightly down, basically the core businesses of emerging markets are up and it's the accrual that will continue to be a drag. And, frankly, it's been -- it has been a drag for the whole industry for some time, as we all know. But what's happened with us is we've managed to substitute this with other revenues that are coming through our distribution capability, but focus very much on the emerging markets.

John Kirk - ***Redburn Partners - Analyst***

Great, thanks a lot. I just have one more relating to the U.K. PFS business and it's just simply to what extent you think that increasing consumer savings activity can offset the slowdown or potential reversal of the lending side of that business?

Mike Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

Well, certainly, we said at the half year we've seen a very significant increase in liabilities growth in the U.K. bank and that's continuing. What we're seeing is that people with the smart money are putting their money in the bank and others are trying to readjust their credit exposure. And obviously, IVAs, etc. are out there. And we purposely, as Douglas mentioned and said earlier on in the year, that we saw that the top of the U.K. market and have not chased market for revenue growth. So -- on the basis that we didn't think the quality was there.

So, yes, we are encouraging liability side. You see it in our rates. You see it in how our private bank and -- is joined together with the retail franchise of the U.K. bank and being joined in by -- with our investment bank as well. I think there's a lot more to go there and it makes sense with our brand being so strong we should be in that area and it's a growth area for us.

John Kirk - ***Redburn Partners - Analyst***

Great, thank you very much.

Operator

Thank you. Our next question comes through from the line of Simon Samuels from Citigroup. Please go ahead with your question.

Simon Samuels - ***Citigroup - Analyst***

Thanks very much, good morning. I've got two or three questions actually. First, somebody's got to ask so I will. I think you must be the only bank in -- certainly in Europe or the U.S. now that doesn't either give quarterly results or comments on trading -- comments on your performance against consensus at your trading update. So, first of all, could you comment against your performance against consensus expectations for the full year?

Douglas Flint - ***HSBC Holdings plc - Group FD***

I suppose since we have a tradition of not doing so, I -- this is not the moment to change it. I think the difference we have, Simon, is that others are talking about dealing with consensus with three or four weeks to go in a single market. We're talking about dealing with consensus where there were three months before closing. We're reporting numbers to you and we're consolidating operations in 80 countries. I think that's a very different set of circumstances. And I think it's been our practice not to comment and I think -- I'm afraid that's going to continue.

But you do know, and we've said it before, that if -- we have an ongoing obligation to make announcements if we believe that the market is at significant variance. Now, that's quite a fluid thing to interpret. But in terms of guiding against consensus, I think when we're in the variety of geographies we're in, it's much more difficult for us, so no.

Simon Samuels - ***Citigroup - Analyst***

Okay. Normally, you say to us it's -- well, if they were materially different you'd have to tell us. So --

Douglas Flint - ***HSBC Holdings plc - Group FD***

That's what --

Simon Samuels - ***Citigroup - Analyst***

But that's what you've just said, yes?

Douglas Flint - ***HSBC Holdings plc - Group FD***

That's what I've just said.

Simon Samuels - ***Citigroup - Analyst***

And material is what, plus or minus 5%?

Douglas Flint - ***HSBC Holdings plc - Group FD***

That's -- material is whatever material is. No, you can't define it with a single percentage, because it depends on the nature of the item as well. And I can send you a 10 or 15 page definition of materiality, which is used to guide in these circumstances, only I'm not sure you'd be more enlightened at the end of it. But if you'd like it I'm very happy to send it to you.

Simon Samuels - ***Citigroup - Analyst***

Tom's saying that we'll take it.

Douglas Flint - ***HSBC Holdings plc - Group FD***

Excellent.

Simon Samuels - ***Citigroup - Analyst***

So, that would be great. Right, then the other questions are, first of all, I just wanted to first of all to understand the precise nature of the wording. You talk about for the third quarter underlying risk adjusted revenue growth year to date is ahead of cost -- underlying cost growth. The -- just -- I'm interested in the associated risk adjusted. I've seen that's obviously the revenues less the impairment charge under IFRS presentation.

Douglas Flint - ***HSBC Holdings plc - Group FD***

Correct.

Simon Samuels - ***Citigroup - Analyst***

Can you just comment at the -- before the impairment charge number? I can't think the impairment charge swings it enormously. So, can we infer from that that underlying revenues pre-impairment charge is equally running ahead of underlying costs for the nine months?

Douglas Flint - ***HSBC Holdings plc - Group FD***

No, I think you've answered your own question.

Simon Samuels - ***Citigroup - Analyst***

Fine, so it's not material, to go back to the --

Douglas Flint - ***HSBC Holdings plc - Group FD***

I think you've answered your own question.

Simon Samuels - ***Citigroup - Analyst***

Okay, thank you. And then can I ask just a couple of more substantive ones? One is I heard what you said to JP's question about you're not going to cut back on spending programs in response to a couple of weak months or, indeed, quarters. But the way you're talking as Group, you're obviously -- there's certain things out there that sounds like they're not really going to change very much in the next year or 18 months. Your risk appetite for large corporates sounds like it's subdued and will be for a while, ditto, U.K. unsecured lending, ditto U.S. mortgage lending.

So, the question is whether we'll look back at second half '05, first half of '06 as a period where you had some positive operational leverage or positive jaws, and then they then turned negative again. Or, is there a commitment that you're going to cut your cost cloth back to a more subdued revenue environment may be going into next year?

Mike Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

Simon, I'll take that. You've heard me speak on this subject before and there are two parts of the Group we look at. One is the developed side and the other is the emerging markets.

Clearly, U.K., U.S. we're looking at all types of synergies across the Group to take costs out of the business. In other areas we're going to be investing, Central Europe, Asia, Middle East. That continues. In Mexico, we've just invested in Banistmo, of course, Central America. All that needs to be joined up.

In short, we're pretty good at managing costs and we'll continue to do that, but we'll continue to invest as well as the opportunities arise, and reengineer the use of technology. I think you will have the opportunity to see our technology IR day here, there is a lot of stuff that we will do. We're not going to say whether that's going to affect the Jjawss, but we certainly know how to manage our costs.

Simon Samuels - ***Citigroup - Analyst***

Okay, thank you. And the last one and then I will shut up. It's just on the U.K. comments and IVAs, which I think probably have gone further than anybody actually in terms of talking about it just going at an elevated level in the medium term, let alone the short term. Can you just -- is your sense that -- it's gone up a lot obviously. Is your sense that it just stays at the current level and it's plateauing now? Or are you actually saying you think it's going to deteriorate from current levels? I'm talking may be to allow you to make it easier to answer may be at the industry level rather necessarily your own experience.

Mike Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

Well, I'll go back to what I said at the half year results. The reality is there are people out there encouraging people to file for bankruptcy or for restructuring. And as such, when you have an industry encouraging people to do that and you haven't got any history of how to manage credit scores around it, one is very much at the position that you've got to work through this social approach that people are taking to their debts and liabilities.

And I reiterated before and I reiterate again, I think it's something that the industry needs to look at. Government needs to look at. Is this the right type of law for what we -- what it was set out to achieve? And I think unless there is going to be a major change in people's personality to debt they will continue to use the IVA route, but not, I think, a very wise thing to do in the long term.

Simon Samuels - ***Citigroup - Analyst***

Okay, thank you.

Operator

Thank you. Our next question comes through from the line of Alastair Ryan from UBS. Please go ahead with your question.

Alastair Ryan - ***UBS - Analyst***

Thanks. Good morning, it's in three parts. First, the third quarter wasn't actually that bad in investment banking, although UBS' numbers are --

Douglas Flint - ***HSBC Holdings plc - Group FD***

Sorry, Alastair, you're breaking up. Can you say again?

Alastair Ryan - ***UBS - Analyst***

Can you hear me now?

Douglas Flint - ***HSBC Holdings plc - Group FD***

Yes, I can.

Alastair Ryan - ***UBS - Analyst***

The third quarter wasn't actually that bad in capital markets, certainly compared with the third quarter last year. Was there anything in your own trading experience which would give you cause for concern? Or is it just particularly that the emphasis of the businesses you had were particularly unhelpful? There was a fairly broad spread of capital markets performance from the guys that have reported in Q3. But it sounds like you'd be at the bottom end of that along with [inaudible].

Douglas Flint - ***HSBC Holdings plc - Group FD***

No, I don't think there's any specific, no.

Alastair Ryan - ***UBS - Analyst***

So, nothing that would give you cause -- a concern about areas you've been investing in, risks you've been taking?

Douglas Flint - ***HSBC Holdings plc - Group FD***

No, no, no. In fact, the areas we've been investing in have been very good. No, it was just not as good as it was.

Alastair Ryan - ***UBS - Analyst***

Fair enough. And secondly, these are all points of clarity actually. It's only two weeks since you talked to us about Household. There's some fairly specific guidance in the third -- in this statement. Is there anything we should look at that? Is it because the market hasn't moved to a place that you think is a right place on impairments for the fourth quarter? Is it that there's been a further deterioration as you've dug through the books and taken a long hard look at it? Or is it just providing us a bit more clarity around what you were saying a couple of weeks ago?

Douglas Flint - ***HSBC Holdings plc - Group FD***

I think we listened to some feedback that said some more clarity and more granularity would be welcome. But I think it's also a case that we've had the ability to see another three or four weeks' data and analyze that data, albeit it's only three weeks since we spoke to him and in the light of analytical data. I think we have seen have more data now coming into the fourth quarter and there is a weakening trend. And that is what we are pointing out.

So, it is A) responding to an understandable desire to give more granularity. But it's also to point out that the situation has weakened since we looked at the third quarter numbers.

Alastair Ryan - ***UBS - Analyst***

And with the exception of the correspondent services business, is there anything that gives you cause to believe that your performance is different than others, of the market?

Douglas Flint - ***HSBC Holdings plc - Group FD***

I don't think we're different in the correspondent business either. I think there's a lot of analytics in relation to 2005 and 2006 purchased loans from correspondent banks and brokers that are performing universally badly across the industry. So, I don't think that we're -- I don't think that we are worse than the industry in those segments. I just think that we have got a fair piece of it.

I think in the other segments what we tried to convey or are conveying is that the delinquency trends are broadly in line with those that we would expect taking account mixed seasonality, seasoning of the book. And also, recognizing that some of the endowment effect, if that's the right phrase, from the accelerated bankruptcy, which made the first quarter in particular, but has had a beneficial impact in delinquency and charge offs through 2006 is beginning to come to an end, i.e. the drag forward of impairment into '05 has -- is beginning to wind down in terms of its impact and will get back to more normalized levels of charge off and bankruptcy next year.

I think -- you know the figures. This year bankruptcies have fallen across the industry by about 70% and they're expected to rise using Visa's figures about 80% next year. So, still less than they were in 2004, but we've had significant timing differences in terms of bankruptcy filing. So, I think we're getting back into more normalized territory.

There is also, I think, a gradual weakening of credit with a slower economy and a slower housing market, but nothing outside at this stage of historical parameters for the business. And that's largely because the traditional or the core business in the finance company is a fixed rate business. And the issue has been in so-called affordability products, stated income and second liens in the real estate security side, where the historical performance of those against, firstly, full documentation, fixed rate products has broken down. And the trends in delinquency are very different taking into account the factors that used to adjust for the product type in terms of having a higher FICO score of origination. That has not been a protection in the current environment. And that's why there's an enormous amount of analytics going on on a very granular basis to get the best insight we can as to where to deploy effort to mitigate the impact.

But it's in -- it's concentrated in that book. I don't think in those products that what we're seeing is out of order with what you would see by looking at the securitization data on similar products originated at the same time. The second lien product, in particular, and we're basically self originating in the third quarter of this year. So, it is a defined segment, a long answer, sorry.

Alastair Ryan - ***UBS - Analyst***

No, that's very helpful, thanks. And finally, just capital guidance, is that pre or post Banistmo?

Douglas Flint - ***HSBC Holdings plc - Group FD***

[Pardon]?

Russell Picot - ***HSBC Holdings plc - Group Chief Accounting Officer***

The capital guidance.

Douglas Flint - ***HSBC Holdings plc - Group FD***

Capital guidance --

Russell Picot - ***HSBC Holdings plc - Group Chief Accounting Officer***

Is that pre or post Banistmo?

Douglas Flint - ***HSBC Holdings plc - Group FD***

Banistmo, it's not going to make much difference.

Alastair Ryan - ***UBS - Analyst***

Okay, thank you.

Douglas Flint - ***HSBC Holdings plc - Group FD***

Fine.

Operator

Thank you. Our next question comes through from the line of Robert Law from Lehman Brothers. Please go ahead with your question.

Robert Law - ***Lehman Brothers - Analyst***

Good morning gentlemen. I've got three areas I wanted to probe if I may. Firstly on CIBM, and this may be for the CEO as well, how much of the payback and the market share gains in the investment phase have we seen?

Mike Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

Right, I'll take that. Do you want me to take it now, or have you got three questions?

Robert Law - ***Lehman Brothers - Analyst***

The second area was can you explain internally your comments on revenue and cost referred to underlying trends, so that you can help us with, obviously, the numbers we deal with. Can you just comment briefly on what kind of adjustments you make when you say that?

Douglas Flint - ***HSBC Holdings plc - Group FD***

Sorry, say again Robert?

Robert Law - ***Lehman Brothers - Analyst***

When you refer to the trends on underlying risk adjusted revenue, in Simon's question he's obviously dealt with the credit loss issue, what other adjustments are you making?

Douglas Flint - ***HSBC Holdings plc - Group FD***

No, no, exactly what we put up on the slide at the Results Day. We adjust for acquisitions and we adjust for exchange. That's it.

Robert Law - ***Lehman Brothers - Analyst***

That's it, okay.

Douglas Flint - ***HSBC Holdings plc - Group FD***

Yes. No, no, same basis, and disposals, it's like for like adjusted for exchange.

Robert Law - ***Lehman Brothers - Analyst***

Fine.

Douglas Flint - ***HSBC Holdings plc - Group FD***

Nothing tricky.

Robert Law - ***Lehman Brothers - Analyst***

Okay. And the third area was in terms of the U.K. credit loss issue. Some of the other banks are talking about early arrears on new business re-stabilizing, may be even coming down, but the bankruptcy issue which you refer to countermanding that. And what I'm interested in is what is your view of early losses on new business, so the net of those two?

Mike Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

Right, well, I'll take the first one, the investment in CIBM. Clearly, when we announced in the strategy of building up the investment bank we've built it in a number of different levels. And Stuart Gulliver is now Head of that and running it.

I think if I was to say anything it's probably bringing it much tighter into the treasury than it was beforehand. So, he's -- you see it in the deals that we've been -- in -- particularly in the steel industry, etc. during the year. He's making sure those M&A deals feed back into the Treasury side of it.

The only overlap that we've seen has been basically in the U.S. with some of the portfolios there. And those have been adjusting over time, there hasn't been a major change or shift to the business. But there has been a much more joining up of the CIBM business with the rest of the Group and that was beginning to become quite powerful. And I'd say that's at its infancy at the present time, but it will go forward.

So, it's more a realigning than eliminating certain sectors. But, clearly, we're basing this more around the customer. And we've always said, there's no point in us trying to take on the bulge bracket banks, because that's what we were there for. We're going to run it round our clients, run it round our distribution capability, and make sure we leverage support by joining it all up together, and that's beginning to come together. Stuart's quite a powerful person at doing that.

On the U.K. credit losses, early losses, frankly, I think you -- when we look at early losses outside of the PFS area, or are you talking PFS area?

Robert Law - ***Lehman Brothers - Analyst***

No, I'm really talking the PFS side.

Mike Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

Right, so, you're really looking at -- on the mortgage side we're not seeing anything deteriorating. So, we're looking on the unsecured side. So, what you're looking at is on the card side and on the personal loan side. Well, frankly, I think you've heard me talk on this subject before.

We took a view well -- earlier in the year. We were very jaundiced about what we saw people doing in the market and decided to step back. So, from a revenue perspective and a market share perspective, you would expect us to have a less market share in unsecured debt than we originally had. And that is what we've done. We've stepped -- because we were concerned that we were seeing amount of losses, early losses appearing. We're not seeing that so much now. But there again, we're not such a major player in that market. So, I think you'd really need to talk to others on that. But certainly, we cut back probably the first quarter, in fact, in the unsecured market and that's helping us.

Douglas Flint - ***HSBC Holdings plc - Group FD***

Yes. I think because the product set was more restricted to people that we had better data on, we are seeing -- it's a different mix, but we are seeing better trends on early stage delinquency, on that. So, the generic comment about IVAs in the market place still remains an issue that it is -- they are growing.

Robert Law - ***Lehman Brothers - Analyst***

No, absolutely. And the point I'm making is that the IVA problem is giving rise to higher losses on default, so a higher severity. And what I'm trying to do is to see is the actual losses you're taking on new business compared to previous business you've written, is that now trending downwards? Or is it still rising?

Douglas Flint - ***HSBC Holdings plc - Group FD***

No, that's trending better.

Robert Law - ***Lehman Brothers - Analyst***

Right.

Douglas Flint - ***HSBC Holdings plc - Group FD***

But it's a different business mix.

Robert Law - ***Lehman Brothers - Analyst***

Yes. And just to come back to CIBM, if I may. And I take the point about the way you've built it and what happens from here is subject to, obviously, continue to grow and market conditions, etc. But as a division is it now operating at the level of cost efficiency, return on capital, etc. that you are satisfied with? Or do we see further payback on the investment phase that you've put in?

Mike Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

Well, I think there's more to be had out of it. I don't see the cost base going up that much more. But in reality we've done the investment. There's a bit of fine tuning. I think there's a lot of evidence that we're winning mandates and positions in league tables reflect that. I think it is a case of now growing out the business.

And it's a powerful division when tied into the rest of the Group. And that's what we're doing now. We -- possibly we weren't doing it as much as we were, say, this time last year. That's in full force beginning from the second half of this year.

Robert Law - ***Lehman Brothers - Analyst***

Thank you.

Operator

Thank you. Our next question comes through from the line of Ian Smillie from ABN Amro. Please go ahead with your question.

Ian Smillie - ***ABN Amro - Analyst***

Morning James, three questions as well please. The first one, at a Group level, again back on the underlying risk adjusted revenue and cost growth, could you tell us what the Q3 year on year is for the Group, please? Whether that is still positive?

Douglas Flint - ***HSBC Holdings plc - Group FD***

That's what the disclosure said. It talks about it's on a year to date basis. The --

Ian Smillie - ***ABN Amro - Analyst***

Sorry, the Q3 alone rather than the year to date cumulative, because obviously it was positive in the first half. And what I'm wondering is whether the Q3 versus Q3 is also positive.

Douglas Flint - ***HSBC Holdings plc - Group FD***

Let me -- just let me try and get -- clearly, Q3 diluted what we saw in H1, because that's we've said. But you're now saying what is the Q3 -- I'm not quite sure what you're trying to get us --

Ian Smillie - ***ABN Amro - Analyst***

Sorry, Douglas. Yes, Q3 2006 --

Douglas Flint - ***HSBC Holdings plc - Group FD***

Yes.

Ian Smillie - ***ABN Amro - Analyst***

Underlying risk adjusted revenue growth versus Q3 2006 year on year underlying cost growth, is that also in positive territory? Or is the fact that the year to date cumulative is positive carrying the benefit of the first half performance?

Douglas Flint - ***HSBC Holdings plc - Group FD***

Yes. That must be right, yes. The third quarter was a weakening trend to the first half. In aggregate over the period we've said that the cost growth was in line with what you saw in the first half and that we show positive risk adjusted revenue over cost. You might infer from that that given that revenue growth has slowed in the third quarter, which is what we said, that the revenue growth cumulative is not as strong as it was in the first half, because that's what we said and that is exactly what we're saying.

Ian Smillie - ***ABN Amro - Analyst***

Okay. And the second question is on Hong Kong, where you make an explicit comment that the outlook is positive. I was wondering whether you could give us a bit more detail there. Is that a margin story on the back of how the rate environment has shifted? There's been quite a lot of moving parts there. Or is that more about the non-interest income and the wealth related drivers?

Douglas Flint - ***HSBC Holdings plc - Group FD***

I think it's both. I think that the -- albeit we've seen rate reductions in very recent weeks, the average yield -- the average interest rates are higher than they were some time ago. And therefore on our free funds and on our low cost deposit base we are seeing better revenues.

And we've also seen a very good fee business throughout 2006 from all the IPO and related activity in Hong Kong. Our insurance business continues to do well. Our CMB business in Hong Kong continues to do very well. And I think that one of the exciting opportunities over the near medium term is expanding our CMB business into Southern China as we have more ability to do so.

So, Hong Kong had a good quarter, and I think the margins and mix continue to move steadily and favorably.

Ian Smillie - ***ABN Amro - Analyst***

And that comment includes the CIBM Hong Kong performance as well does it?

Douglas Flint - ***HSBC Holdings plc - Group FD***

Yes, it does.

Ian Smillie - ***ABN Amro - Analyst***

Great, thank you. And the third question is you've encouraged us to think about the change in the way that you're running the U.S. Mortgage Services business. Can you very briefly tell us how that should change our expectations of, firstly, your exposure, which you keep to -- or any exposure which you keep to mortgages securitized in terms of credit risk?

And secondly, how that should change the revenue, because presumably it's shifting away from net interest income and into some sort of flow revenue instead? So, just a little bit more guidance there to the moving parts would be great.

Douglas Flint - ***HSBC Holdings plc - Group FD***

Yes, I think within what we call Mortgage Services there are essentially two businesses. One was -- one is called Decision One, which essentially aggregates from brokers and 75 to 80% is distributed to securitization. The other 20 to 25% is effectively placed in portfolio. There's no particular magic as to which goes bit goes where. It's just some of it goes in portfolio and the rest goes into the external market.

The Mortgage Services business, which essentially purchased from correspondent banks and also some brokers, was a business that was historically -- or -- for portfolio. We originated for portfolio, I think, partly as a reaction in terms of the aggregate amount of growth we've achieved over a number of years. And secondly, in light of -- or in order to better improve the pricing metrics, we want to see more of a production, if not the vast majority of the purchased loans, being dealt with on a securitized basis.

So that business, just as we've seen Merrill's, and Morgan Stanley, and Bear, and Lehman all buy sub-prime mortgage originators to feed their securitization businesses, we have built over the last couple of years a securitization mortgage-backed trading capability in New York, which we now are linking. And it's now big enough and ready enough to link with our mortgage -- sub-prime mortgage origination through purchasing. So effectively make that a business that would prospectively be far more about the securitization desk in New York than building for portfolio. And partly that is a response to what's happened, but it's also partly a response to the build up of the capabilities that we have in New York.

Ian Smillie - ***ABN Amro - Analyst***

And in terms of how that change is going to impact your financials, any broad guidance there?

Douglas Flint - ***HSBC Holdings plc - Group FD***

Well, I think in the short-term, again, we made reference, or short and medium-term, reference in the statement that just from a mix perspective, as growth is constrained, published delinquency will rise, because there isn't the mix impact of the freshly purchased, non-seasoned production, so you will see a rising delinquency trend accelerate, simply because of that mix effect.

And it will clearly have an impact on revenue growth within the finance company, which will in part be substituted for gains on securitization activity, which I guess will be shared between the finance company and the CIBM platform in New York. It will just be a different revenue mix, so there'll be less -- it will be another income kind of item more than just interest costs and all that impairment cost.

Ian Smillie - ***ABN Amro - Analyst***

Thank you, Douglas.

Operator

Thank you. Our next question comes through from the line of Michael Helsby from Fox-Pitt Kelton. Please go ahead with your question.

Michael Helsby - ***Fox-Pitt Kelton - Analyst***

Morning gents, I've just got three short questions please. I think your peers on the investment banking side have given us some insight into the pipeline in Q4, and I think pretty uniformly across the board, people have said that the pipeline has been very strong. I was wondering if you could give us a comment on what you're seeing.

Secondly, you talk about the corporate trends remaining very benign, but clearly you've pulled back your risk appetite there. I was wondering if you could make a specific comment on the U.K. market?

And then just thirdly, more of a broader question. As I read this statement I think, in your final remarks, Douglas, at the outset, you said that you were well placed to cope with the challenges. It feels like this is a statement that says you've drawn your horns in quite noticeably. If I think back towards the period of 2001 to 2005, and the switch in Managing to Value to Managing for Growth, should we think that you're stepping back from the Managing to Growth and moving more towards a batten down the hatches type, or is that just being a bit extreme?

Mike Geoghegan - ***HSBC Holdings plc - Group Chief Executive***

I'll take that. Firstly, I think you shouldn't read too much into this. Managing for Growth is still exactly what it is. But all I'm saying is, it needs to be quality growth, and we won't chase revenues just to make that growth line work in the short-term to take it below the line later on. Clearly I've said it publicly before. I've seen -- well, I've been around here for a long enough time to see some of the covenants that I know are now missing in most loan documents, pretty concerning for an industry. I suppose you can call it deja-vu. We've been there before on these scenarios.

So it’s not a case of pulling in our horns, but we are being cautious of the underwriting qualities, and seeing how some of this debt can be placed in the market, and will it continue to be placed as easily as it has been in the past? There are two chains of thought. I'll be very open about it. There are others far more bullish on it than I am in regard to the U.K., and all I'm saying is that we will stay around our clients, but we won't go up just to build and grow business that in the end, just comes down to below the line.

On the question of the pipeline for the Investment Bank, we generally don't speak about what we've got. Obviously we are dealing with clients here, but we're comfortable that we've got the team up and running, but you've seen the deals that we've been involved with. They're substantial deals. We're recognizing the market as being able to do these deals and put them away, and we will continue to do that, and we're positive on the business.

Michael Helsby *- Fox-Pitt Kelton - Analyst*

Okay, thank you.

Operator

Thank you. Our next question comes through from the line of [Alistair Stewart] from Merrill Lynch. Please go ahead with your question.

Alistair Scarff *- Merrill Lynch - Analyst*

Hi, good evening from Hong Kong, just two quick questions if I may, Douglas. First one is in relation to your balance sheet revenues, just a comment that the rate of decline slowed. I was under the impression that at the half year, you basically hit trough levels of revenues from that business. I was wondering if you could give some color as to how that is progressing?

And secondly, in terms of which product groups are feeling the greatest margin pressure? Obviously it's a very broad-based question, but if you could possibly highlight maybe the top one or two where you're seeing the greatest margin pressure?

Douglas Flint *- HSBC Holdings plc - Group FD*

Okay, I don't think we gave indications at the interim that balance sheet management revenues were -- had troughed. I think it is clearly a response to the interest rate curves that we have around. What we're -- we have seen some good progress towards the end of this year as is in Hong Kong. And as the third quarter was, as we've described it, a period where balance sheet management revenues were weaker, but they were weaker at a considerably lesser rate than they had been in preceding quarter-on-quarter comparisons. And therefore I think at the moment, if everything stayed as it is, we would hope to see in the early part of 2007, a trough, as you've described. That's not a prediction. It's a -- if everything stayed as it was.

In relation to margin pressure, I think we see margin pressure pretty broadly actually. In Hong Kong, all asset products are facing pressure on the asset side because of the high liquidity in the marketplace. And indeed, high liquidity generally is probably the single biggest contributing factor to corporate credit margins, and indeed, retail credit margins, being priced aggressively.

I think in the markets like the U.K. and unsecured where there has been some shock in terms of unexpected delinquency, and I guess you're seeing it now in the U.S., in segments of the real estate secured market, you're beginning to see prices respond very, very quickly and aggressively to those changes. But where loss expectation and severity continues to be low, then more and more liquidity is being concentrated on those products. And therefore, I think, mortgage product around the world absent some of the affordability products, so-called in the U.S., continue to be priced very thinly. It's across the board, and I think it is really a reaction to the liquidity there is in the market.

Alistair Scarff *- Merrill Lynch - Analyst*

Great, thank you.

Operator

Thank you. Our next question comes through from the line of Tom Rayner from Citigroup. Please go ahead with your question.

Tom Rayner - ***Citigroup - Analyst***

Yes, good morning, it's Tom Rayner from Citigroup here. Sorry to go all the way back to the U.S. credit quality again, but I'm still a bit surprised that just three weeks after updating us, the guidance is shifting again to greater weakness. I'm trying to get a sense, when I look at what you put down as having the biggest impact, you're now talking about higher rates feeding through into the resetting of the adjustable rate mortgages. Are you still -- those comments, are they still referring very much to the consumer finance book, or are we now seeing some spill over into the banking book as well, in terms of mortgages?

Also on the delinquency trends, which are now in the finance corporation rising at 0.4% per quarter, can you give us any sense for how long you think that trend may continue until you start to see some stabilization?

Douglas Flint - ***HSBC Holdings plc - Group FD***

I think just on your mortgage point -- I'm getting feedback off you. Can you shut down at your end, because you're --

Tom Rayner - ***Citigroup - Analyst***

Sure.

Douglas Flint - ***HSBC Holdings plc - Group FD***

Going back. Yes. I think on the adjustable rate point, the comment is specifically directed to the finance company. However, I think as a more general economic observation, we have pointed in the past to, that one of the risks, particularly in '07, where the vast majority of our adjustable rate product is in the prime space, one of the uncertainties and risks is the diversion of discretionary income in the prime space away from consumption to debt service, not to the extent that it impacts the ability of prime customers to make their payments, but it will impact the amount of other things that they spend money on. And therefore, that will have an impact on production over time, and ultimately employment, depending on what's happening elsewhere in the economy.

So I think there is a macro impact on the rate we set, which will be progressively larger through 2007, and large in particularly Q3 and Q4 '07. We've only really seen the early stage of adjustable rate resets. Now, clearly, rates could come down in the U.S. There are some people who think that that might happen, and that would obviously have an impact, both on the severity of the diversion of disposable income to debt service, and will also have an impact on the ability of customers to refinance before their rates reset. And there still is a high number of customers who are able to, in both the prime and the sub-prime space, refinance ahead of the reset date. And a considerable amount of the work that we're doing with customers faced with reset product is to talk to them about finding accommodations or indeed, helping them to refinance elsewhere. That's the comment on adjustable rate.

In terms of will the trend continue, yes, I think it will continue. Whether it continues at 40 basis points, which was your number, I don't know. But clearly, there are a number of drivers going into 2007 which are not getting better. The slowdown of the housing market, the decline in some areas of house prices, a modestly weaker economy, and the impact of adjustable rate resets, together with the, I guess the -- as I pointed to before, the lack of benefit from the acceleration of delinquency that we had the benefit of through the first two, and maybe into the third quarter of '06. So that's just as a technical factor, if you like.

But certainly our preparation for '07 is based on there being a continuing trend towards higher delinquency. And I think that's modeled across the industry, and in terms of the forecast for the particularly -- but particularly the 2005 and '06 production, which we purchased, and was purchased by the industry. That is the element of the portfolio where the historic, the ability to use historic data to predict outcome has ceased to be effective. And we're monitoring it, therefore, on a very, very close basis.

Tom Rayner - ***Citigroup - Analyst***

Okay, thanks a lot.

Douglas Flint - ***HSBC Holdings plc - Group FD***

If there are no further questions, and as we've almost uncannily got to the hour, although we're quite happy to go on, if there are no further questions, Operator, we'll -- do you have any more? If there are no further questions at this stage, thank you to who is on the call. Thank you very much for joining and we look forward to speaking with you in early March, when we present the full year results for 2006.

Operator

Sorry, we do have some further questions if you can take them. Sir, apologies.

Douglas Flint - ***HSBC Holdings plc - Group FD***

No, I'm happy to take them, but everything went quiet. I'm getting feedback again, so --

Tom Rayner - ***Citigroup - Analyst***

I think I might still be on the line, am I?

Douglas Flint - ***HSBC Holdings plc - Group FD***

I think you might be, yes.

Operator

Apologies. Our next question comes from the line of Mark Thomas from KBW. Please go ahead with your question.

Mark Thomas - ***KBW - Analyst***

Hello, everybody. Sorry, it's just -- I'm afraid I'm still very confused in terms of why the 2005 and 2006 vintages in the U.S. mortgage book are not behaving? What has actually -- what's your view as to what's actually changed in the customer behavior? And therefore, if we're inclined to look forward, what sort of lead indicators can we possibly look at to see if we can actually anticipate further changes, either better, or worse in terms of that customer behavior? So what are your analytics actually telling you has gone wrong?

Douglas Flint - ***HSBC Holdings plc - Group FD***

Well, I think 2005 and 2006 will probably be regarded as the peak at this point of the U.S. housing market. And therefore a considerable amount of activity, particularly in the broker channels, and 80% of U.S. mortgages go through brokers, moved away from more traditional products to affordability products, so adjustable rate mortgages, stated income products, and second liens products, as well as option adjusted ARMs. We didn't do any option adjusted ARMs, but they were in the marketplace.

So essentially there were a large number of products being written that were helping people afford higher capital sums with lower monthly outgoings. Historically, the higher risk for those products was dealt with through raising the FICO scores at which the products would be underwritten. And if you like, the higher risk profile of the products would be adjusted for by a higher credit score of those being eligible for the products.

What is now clear is that FICO scores are less effective or ineffective in circumstances where the ability to meet payments is beneficially enhanced by virtue of the fact that the payment obligations have been reduced because of very low interest rates. In other words, the FICO scores' predictive ability, because people weren't missing payments, were recording higher credit worthiness than might have been the case if they had had to make payments at more normalized interest rates, or without the benefit of affordability elements into the products. So they were miss-scoring credit characteristics. And that was a feature of the 2005 and 2006 production, right across the industry, which moved very, very heavily from almost exclusively from traditional products to what are known as, or what have become known as affordability products. And the ability to predict loss changed.

I think the other thing that changed was that effectively a proportion of those people were using affordability products to make house purchases as opposed to what is the core business in the finance company, which is consolidation lending, i.e. people who have been in the house a long time, and they consolidate unsecured debt into a real estate secured mortgage. The end of '05/'06, a lot of this product was not consolidation, it was basically people stretching to afford houses. And therefore, as payment shock came through from resetting, or higher rates, or whatever other payment shock might come through, there was very little ability to deal with that, and with house prices not rising, there wasn't the ability to re-finance away or to sell and settle. This all happened in a relatively short space of time between mid 2005 through mid 2006, coincident with turmoil, clearly, in the industry, or turmoil in the U.S. in relation to Katrina and the change in bankruptcy, so the trends were complicated by that. That's not an excuse. It's just an observation.

Mark Thomas - ***KBW - Analyst***

Perhaps I could come back on it. There is one aspect to this I find quite amazing, that you can originate mortgages in 2006, where there doesn't seem to have been a reset in terms of adjustable rate that quickly, and yet you're saying that there's a problem in terms of affordability products on 2006 mortgages. What -- that must imply that some form of affordability scoring in 2006 completely missed the affordability pattern of the customer in 2006?

Douglas Flint - ***HSBC Holdings plc - Group FD***

That's true. The other element, though, Mark, is that a high proportion of the products being originated at that time were second lien and therefore behavior has changed as the properties don't rise in value, or even modestly decline in some areas.

Mark Thomas - ***KBW - Analyst***

Okay, and then in terms of anything we can actually in any way, shape or form measure in terms of lead indicator, would it just be house price inflation then?

Douglas Flint - ***HSBC Holdings plc - Group FD***

I think in terms of lead indicators, I'd look at house prices. I would look at the liquidity and pricing in the securitization markets because there is a great deal of this paper in the securitization markets. And I think both the pricing of it and the depth and liquidity of the markets are important. But I think it's a discreet population. We clearly -- we're at the end of '06, but the population of affordability products written in '05 and '06 across the industry has closed, and it will now work its way through.

But we have significantly cut out the products that have caused the unexpected losses, and therefore it's a question of working out what is in the U.S. rather than adding to it. But we're not doing second lien, and we're doing stated income on a very much more restricted basis. And the scores have been, again, augmented by another judgmental factor, to make them higher. They already had been, but it had been inefficient -- sorry, had been ineffective.

Mark Thomas - ***KBW - Analyst***

Thank you.

Operator

Thank you. Our next question comes through from the line of Daniel Davies from Exane BNP. Please go ahead with your question.

Daniel Davies - ***Exane BNP Paribas - Analyst***

Thanks very much. Morning guys. Just to ask really, about the effect that the new risk environment is going to have on capital and dividend policy, because back in May, Douglas, you said that you were continuing to see asset growth and capital deployment opportunities with attractive returns consistent with the amount of capital we are retaining. Since then, the risk appetite's declined in large corporates, and in U.K. and U.S. retail, and you're going to be securitizing more mortgages. So really, I'm just wondering whether that means you're going to be retaining less capital going forward, or whether there are other opportunities for deploying the capital which are going to take up the slack?

Douglas Flint - ***HSBC Holdings plc - Group FD***

We continue to see good opportunities across Asia. We continue to see good opportunities in Latin America, Middle East, Turkey, and we've talked about building out organically in a modest way in Eastern Europe. I think we continue to see good opportunities. There are elements of the portfolio that we have, as we said, constrained. There are other elements in the U.K. and the U.S. that continue to grow steadily. So it will be a balance.

If we get to the stage -- if we get to the position that the growth is less and the profitability is the same, then clearly we would be requiring to retain less capital. So we would either allow our capital ratios to rise or we would distribute more, but that would be a decision taken in line both with current experience and circumstances, and where we saw things going in the future. But you analyze the situation right.

Daniel Davies - ***Exane BNP Paribas - Analyst***

Thanks.

Operator

Thank you. Our next question comes through from the line of Bruce Packard from Societe Generale. Please go ahead with your question.

Bruce Packard - ***Societe Generale - Analyst***

Morning, it's Bruce Packard. I was just -- I guess I'm just slightly confused about the Champion mortgage loan portfolio as well that -- given that you've talked about your ability to predict loss isn't so good now, it looks like you're still buying sub-prime mortgages?

Douglas Flint - ***HSBC Holdings plc - Group FD***

It's a very different portfolio. It's a retail origination model. It tends to be low loan to value. It's about 65% and it's a lower debt service cost than we have elsewhere in the Consumer Finance operation. There's no stated income. It's a full income verification product, and 80% of its first lien. So it's a higher quality segment, and it dovetails well with what we've got in the consumer branch based businesses, where their own retail mortgage experience has been in line with their estimates.

It was in the mortgage -- and the retail branch channel did not do stated income loans. It does 95% fixed rate loans, so it's not in the adjustable rate mortgage space. And it does second liens on a different basis, and they are smaller than was done through the Mortgage Services channel. This dovetails nicely with us, and we think there are cross-sell opportunities. So it's very different from the segment that we have a problem in.

Bruce Packard - ***Societe Generale - Analyst***

Okay, thanks. That makes a bit of sense.

Operator

Thank you. We have a question through from the line of Robert Law from Lehman Brothers. Please go ahead with your question.

Robert Law - ***Lehman Brothers - Analyst***

Hi everyone, sorry. I should have asked this earlier. In follow-up to JP's question about the cost trends, perhaps I can ask it in a way that you can answer. Historically, you've had a seasonal bias for the cost/income ratio derived in the second half of the year. But could you comment on whether that is normally a fourth quarter event or a third quarter event?

Douglas Flint - ***HSBC Holdings plc - Group FD***

I think it's a combination of both, Robert. I think the third quarter -- there are some simple things that -- the taxpayer services business in the finance company is a key one, non-recurring revenue stream. There is a large amount -- there tends to be a higher proportion of mutual fund and investment business done around the end of fiscal year end, which tends to be in the first half of the year. There are essentially three holiday months in the second half of the year, July, August and December. The annual pay rises that are in the Group are in April, and therefore, the second half has got two quarters with whatever rate rises have gone through the payroll, whereas the first half has only one quarter. So there are strong seasonal and mix factors that do impact the relative rates of growth of costs and revenues in the second half versus the first half.

And on top of that, in the cards business, and in the personal lending businesses, there tends to be a higher level of marketing spend ahead of the holiday spending in Thanksgiving, Christmas and New Year, whereas the revenues that may follow from that would fall into the first quarter of the following year. So there is a seasonal impact.

It's difficult to say. It's in both the third and the fourth quarters. December can be a perverse month. It can either be very, very quiet or it can be incredibly active, and it's difficult to predict what happens. It just depends when other people have shut down for the end of the year, or whether there are economic factors out there that force a lot of people to do things before the end of the year. So December is always the most difficult month to predict. But the structure factors that I've mentioned are probably the most important.

Robert Law - ***Lehman Brothers - Analyst***

Thank you.

Operator

Thank you. Our next question comes through from the line of Derek Chambers from Standard Equity Research. Please go ahead with your question.

Derek Chambers - ***Standard & Poor's Equity Research - Analyst***

Yes, sorry, it's Derek Chambers from Standard & Poor's Equity Research. Early on in your statement you refer to the continuing strong performance in the emerging markets, as you defined them, at the first half, and I was wondering a couple of things about that. One is do you have any comments about how the China associates are performing?

And the other is, has the Middle East and Saudi Arabia business continued to grow profits in the same weight as the first half?

Douglas Flint - ***HSBC Holdings plc - Group FD***

Well, I shouldn't comment on the associates, because they're public companies, and I think you can see what they do. You will see, though, however, that both of them have, in the near-term and in recent months, announced plans to raise equity because of their strong growth. So they continue to have ambitious growth targets and I think they continue to do well.

The Middle East continues to be a strong area of growth. There were especially strong, indeed, one might say, euphoric equity markets in Saudi Arabia in the first half, which clearly came off in the second quarter. And therefore the exuberance that was in the Saudi first half for equity market activity will not be as much. But again, they've published their own quarterly numbers, so you can see that.

I'm not sure there's anything else to say. I think one of the very encouraging features of the third quarter was that the, whatever it was, dozen or so countries that we separated out as, quote, 'emerging markets', continued to grow in the same degree of growth as they did in the first half, and that is where a lot of our incremental, organic investment spend is being made.

Derek Chambers - ***Standard & Poor's Equity Research - Analyst***

Okay, thank you.

Operator

Thank you. Our next question comes through from the line of Mamoun Tazi from Man. Please go ahead with your question.

Mamoun Tazi - ***Man Group of London - Analyst***

Yes, good morning gentlemen, three questions. One, the first one on CIBM. I'm just trying to understand the appetite for risk, and have we seen any change in the appetite for risk, relative to the first half of the year? And the other question is about, will you use more, or take more risk on, in order to compensate for the weakness in revenues, whether it's from a seasonality or from the cyclical factors?

The second question is about currency hedges. My understanding is that you don't have any currency hedges in place, especially relative to the dollar. When would you consider putting in place currency hedges?

And the third question is about Metris. It's been almost a year since you've done the acquisition. Any positive or negative surprises from the Metris acquisition? Thank you.

Douglas Flint - ***HSBC Holdings plc - Group FD***

Okay. In terms of CIBM risk appetite, no, there has not been a change from what we said at the half year. We disclosed that the value at risk within CIBM had gone down, largely because of the flat yield curves, and i.e. there was no particular reward for taking on risk in the balance sheet management activities. And that has been taken down, so our sensitivity to interest rates on the accrual books is lower. We absolutely, categorically, definitively would not take on more risk to make up for slower revenue growth elsewhere. That would be, if anything, we would tend to be cautious if there was a higher risk profile elsewhere in the business, but no, we would not change our risk profile to try and compensate.

Currency hedges, you're absolutely right. We do them extraordinarily rarely, and really, only in very small -- in minor currencies, if there was a likely, possibly either a dramatic realignment contemplated, or we were thinking of changing our investment in a particular country. But they are absolutely the exception rather than the rule. We would certainly not be hedging major currencies, because essentially, we are, to the outside world, a mix of dollar, dollar link, euro and sterling. And I think that people buy us for our currency mix, or if they buy us, they should expect the currency mix to be as it is, and therefore, we would not hedge our major currency positions, certainly not without making that clear. I can't think of circumstances where we do.

Metris has performed better than we expected at the time that we acquired it, and indeed, the credit card business in the U.S., partly because of the acceleration of bankruptcy into last year, but the credit card business generally in the U.S. has had a very, very good performance this year, and Metris has shared in that.

Mamoun Tazi - ***Man Group of London - Analyst***

Great, thank you very much.

Operator

Thank you. We have no further questions in queue. [OPERATOR INSTRUCTIONS].

Douglas Flint - ***HSBC Holdings plc - Group FD***

Right, well, I think we've gone a bit over, but we didn't want to constrain questioning. I think we've had a good airing of the issues, so I think I will take the point, the opportunity to draw a line. Thank you very much, those of you up late in Hong Kong, or early if you're in the States, and those in Europe, for joining us.

If there are thoughts that strike you after the call has formally ended, then you know how to get through to us in the normal way, through Investor Relations, and we'll do our best to clarify anything that, as you look at your notes, isn't quite as clear. So thank you again, and we look forward to speaking with you in March about the 2006 results. Thank you very much indeed.

Operator

Thank you, ladies and gentlemen. That concludes HSBC Holdings' pre-close trading update. You may now replace your handsets.