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PRESENTATION

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Well, good morning, ladies and gentlemen, and apologies for keeping you waiting for a few minutes. Good evening in Hong Kong, it's a pleasure to welcome you there to HSBC's 2009 annual results presentation. Once again, as you can see, we've got a satellite link so that we can jointly present in both London and Hong Kong. If you were with us at the interims, you will have noticed that this time Mike and I have swapped locations.

Last year on our board we made a number of changes to management responsibilities at HSBC. We did this to ensure that the Group remains fully prepared for the challenges and the opportunities, and today's Executive lineup now reflects those new responsibilities. In Hong Kong we're joined by Mike, who's the Group Chief Executive, who assumed responsibility for Group strategy in September and relocated to Hong Kong last month. Peter Wong, the new Chief Executive of the Hong Kong and Shanghai Banking Corporation, and Sandy Flockhart, who's taken on the role of Chairman, Personal and Commercial Banking. Also on our Hong Kong team today, Iain Mackay, Chief Financial Officer for Asia Pacific, and Russell Picot, the Group Chief Accounting Officer.

With me in London, Douglas Flint, the Group Financial Officer, who also assumed responsibility for regulation and compliance and risk for the Group last September, and Stuart Gulliver, who's now Chairman of Europe, Middle East and Global Businesses, and assumed responsibility for Private Banking in addition to his responsibilities for Global Banking and Markets. In a moment Douglas is going to run through the figures in some detail. Mike will then cover the Group's business performance for the year. But before he does, let me say a few words, if I may, about the financial highlights.

So, before we start with the presentation, please take a minute to read the usual forward-looking statements on the screen. For the avoidance of doubt, in today's presentations the dollar we talk about is the US dollar unless otherwise stated. It's amazing how careful you have to be.

And so now to our key financial highlights. We've reported pretax profits in all three years since the crisis began. And in another difficult year, these results are a testament to the quality of our team. Underlying PBT $13.3b, up 56% ex the goodwill write-down. Reported PBT $7.1b, down 24%. Tier 1 ratio at 10.8%, which was above our target range, assisted by a capital generated in every quarter. And a core Tier 1 ratio which closed the year at 9.4%.

We indicated at the time of the rights issue that if successful we would increase the Tier 1 capital ratio by about 150 basis points. In fact the rights issue combined, as I mentioned, with capital generation in each quarter, delivered an increase of some 250 basis points. Total dividend in respect to 2009 is $5.9b. HSBC has declared dividends over the last three years in total of over $24b. Now let me hand over to Douglas to take you through the detail.

Douglas Flint - ***HSBC Holdings plc - CFO, Executive Director, Risk and Regulation***

Thanks, Stephen. I start as usual with reported results. This slide sets out the numbers as reported, except that we've separated out the goodwill impairments in respect of North American PFS from last year and movements in the fair value of our own debt related to credit spread, which we do not include in managed performance. You can see that on a reported basis our performance was broadly in line year-on-year excluding these two items. I should also say something about the very low tax charge we incurred. The reason for this simply is that the majority of our profits were generated in lower tax territories, while we reported a loss which was tax effective in the United States. Before looking at the numbers on an underlying basis, I want to set out the significant factors in this year's accounts and remind you of those we set out last year.

I would make three main points. First, as you can see, the year-on-year movements in the fair value of our own debt was some $13b, with movements in 2009 essentially reversing the gains we took in 2008. Secondly, the goodwill impairment recorded against North American PFS in 2008 clearly didn't recur. And thirdly, the write-downs in Global Banking and Markets were some $5b lower than last year. Impairments in our available-for-sale debt securities rose. However, this was in line with the guidance we gave you at this time last year.

Now turning to an underlying basis. This slide adjusts for constant currency, acquisitions and disposals, and strips out the fair value movements I mentioned above. In addition we've adjusted for the goodwill impairment in 2008. On this basis pretax profits increased by 56%, driven by the stronger performance across many of our businesses in Global Banking and Markets.

Turning to capital, there are perhaps three points again to highlight. First, as the Chairman has already remarked, we achieved an improvement of some 250 basis points in the Tier 1 ratio, largely as a result of the successful rights issue, together with internal capital generation. Our core Tier 1 ratio also increased by some 240 basis points. Secondly, our capital ratio improved in each quarter, and our attributable profit adjusted for fair value, which is not a capital movement, was more than twice the dividend paid net of scrip. Thirdly, risk-weighted assets were marginally down, largely due to the run-off of consumer finance assets.

You can see from this slide our liquidity position remains very strong. Retail inflows were driven by Asia, where they increased by 8%. The reduction in customer accounts in Global Banking and Markets is simply due to a more normal pattern of wholesale customer behavior and a return of liquidity to the market. In Europe, a modest growth in credit was led by an increase in mortgage lending in the UK against which we have conservative loan to value ratios. The main reason for the decline in North America was, of course, the continuing reduction of balances in the US consumer finance run-off portfolio, and this was accompanied by lower impairment charges. The other significant change was in the Middle East where the decline in economic activity, particularly in construction, led to a rise in loan impairment charges. Overall loan impairments were down modestly in 2008, driven by the improvement in the United States.

We turn to our commercial books. Unsurprisingly in the economic conditions, loan impairment charges rose, but they did so largely from a historically low basis. The decline in loan balances predominantly reflects lack of customer demand. However, we did see demand beginning to pick up in Hong Kong and the rest of Asia towards the end of the second half. We saw significant increase in loan impairment charges in Europe, largely in services, investment companies and property. We also saw major increase in the Middle East for the reasons already described when talking about PFS.

Moving on to risk in Global Banking and Markets, we saw significant decline as I've said in write-downs in 2009. Loan impairment charges increased, however, reflecting the economic difficulties faced by a small number of global relationships. On top of this we recorded impairments on an element of the asset backed securities portfolio. However, within the asset backed securities portfolio, as a consequence of much improved liquidity and greater transparency of the underlying risk during 2009, we saw a significant improvement in price, and this contributed to a $6.5b reduction in the AFS reserve during the year. At this time last year we indicated an expectation of impairments of $2b to $2.5b over the period 2009 to 2011. Current expectations are towards the upper end of that indication. Similarly, we indicated expected losses ultimately of $600m to $800m, over a slightly extended period. And our current expectation is just a little bit above the top end of this range.

That concludes the financial performance, and I'll now hand over to Mike to take us through the business performance in more detail.

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

Thanks, Douglas. Before I take you through our business performance, I want to cover four important points, which together tell a clear story about the health of our business and our priorities for the future.

I said last year that 2009 would be difficult for all of us, and it was. It was therefore our priority to support our customers in the face of the global recession. We continued to lend to people and to businesses. We made available $5b of extra credit to SMEs and GBP15b of new mortgage lending to UK households. Now customers, new customers, are also turning to HSBC. Premier customer numbers increased by 27% to 3.4m. And Commercial Banking customers increased by 10%.

Second, we stuck closely to the fundamentals of banking, and we make no apology for that. We grew deposits in both Personal Financial Services and Commercial Banking by 7%. This might sound like a perverse strategy in the current interest rate environment, but at HSBC we are building the business for the long term. I'm no economist, but last month the US Fed reminded us that rates can only go one way, and that's up. And that's good for HSBC with its 77% AD ratio.

Third, our results show that universal banking works. And in 2009 Global Banking and Markets was best able to seize the opportunities, offsetting lower demand and deposit spread compression in the other business areas.

Fourth, we've further built our presence as the world's leading international bank. By 2009 I was in no doubt if we were really serious about building on our emerging markets strength then as Group CEO I needed to be at the heart of the action. The Asian growth story continues. Factory production in China is up, shopping malls are full, port and airport freight traffic is increasing. Since last month I've been running our global businesses from the fastest growing region. I will continue to travel for more than half a year. I will also be in London every month. But we are also very clear, the opportunities aren't limited to Asia. We see opportunities in every market in which we operate.

Now turning to our 2009 business performance. We made real progress on costs efficiency, delivering significant positive jaws. Despite the obvious economic challenges HSBC grew underlying revenues by 8%. At the same time we drove down costs by 4%. Our One HSBC program will continue to be instrumental in driving greater efficiency. It will help us to manage products and services consistently across the world to the benefit of customers and shareholders.

I will now take you through each business area, starting with Personal Financial Services. It's not surprising that PFS had a tough year, and that profits were constrained. The low interest rate environment has been hard for depositors and for deposit-takers alike. And contrary to the perceived view that all banks benefit from low interest rates, that is not true for HSBC because our significant surplus liquidity is on-lending to the market for the benefit of those banks that haven't got the core funding base of HSBC. Consequently as a highly liquid bank our profits were more constrained on the liability side than most. But despite this, revenues held up well. The contribution from insurance increased in 2009, proving the value of our wealth focused strategy. What's more, emerging markets represented nearly two-thirds of insurance profits.

I've already mentioned our success in Premier. And at the beginning of this year, we launched HSBC Advance, for aspiring professionals. We expect to have 0.5m new accounts across 30 markets by year end.

In Commercial Banking, despite the tough environment, we were profitable in all regions. Some government-influenced Western banks retreated to their home markets. We continued to win new commercial banking customers, almost 60% of them in emerging markets. We also grew our strong deposit base, which is our platform for future expansion. Loan impairment charges rose, but remained low given the size of our business and the economic climate.

We have built our Global Banking and Markets business into one of the world's top wholesale banks. In 2009 seven businesses each delivered more than $1b in revenues. As a result we achieved exceptional underlying pretax profits of $10.5b. This success has not gone unnoticed. Euromoney named HSBC Best Global Bank in 2009. This slide shows the broad diversification across our customer-focused businesses. And in balance sheet management, revenues earned were significantly higher because we successfully positioned earlier for lower interest rates.

Contrary to public popular opinion, not all banks have been successful. At the time lower rates were not given, so this is as a result of proactive judgment on our part. We expect these revenues to reduce in 2010, but there will still be opportunities to generate income.

Faster growing markets where interest rates have not been pushed so low accounted for over half the profits. Some are suggesting that banks in the USA, UK, Europe and Japan have only profited from bailouts from quantitative easing. But in the majority of the 88 countries and territories where we operate, government hasn't used taxpayers' money to support the financial system. Instead many have allowed their economies to adjust by market forces.

HSBC's Private Bank won a number of awards and was again named Euromoney's number two private bank. The business delivered an underlying pretax profit of more than $1b. This was down 21% as a result of lower client risk appetite and weaker equity markets in the first half of the year. Overall net new money fell. However, we were encouraged by the net inflows of $6.6b from emerging markets.

I will now turn to our regional performance. Asia accounted for over $9b of our underlying pretax profits and although deposit spread compression impacted profits, we grew our deposit base by 8%. Here in Hong Kong we consolidated our position as the number one bank. We remained market leader in mortgages, cards and insurance. One in two people hold a bank account, life insurance product or pension product with HSBC. Loan impairment charges were down 35%.

I am especially proud that HSBC is the leading international bank in mainland China. Some international banks sold their stakes in Chinese banks for short-term gain. Our continued commitment stands in clear contrast. The market value of our strategic investments increased to over $25b last year. This compares with an acquisition cost of $4.5b and a book value of $11b. At the same time we expanded our own HSBC retail network. And we expect to open our hundredth outlet soon.

We have continued to invest in core parts of the business even as we manage to reduce our cost base overall. As the economy grows, we're also supporting Chinese companies as they expand. For example, we launched a renminbi trade settlement service in seven Asian countries. Some are talking of asset bubbles, and some fear that growth is unsustainable. But I believe this could be overblown. And not least because of the high proportion of cash buyers for property and the conservative loan to value ratios. The investments China is making in infrastructure and welfare will lead to higher domestic consumption and a healthy rebalancing of the economy.

We also invested in other fast-growing Asian markets. We doubled our presence in Indonesia and were the first foreign bank to incorporate locally in Vietnam.

Now let's turn to the Middle East, where 2009 turned out to be an extremely challenging year. HSBC's underlying pretax profit was down 74%. Deposits and lending portfolios reduced overall and loan impairment charges rose to unsatisfactory levels. We took firm action with conservative provisioning, which is our hallmark approach at HSBC. We believe the outlook for the region's economy remains strong. We are fully committed to the Middle East. And we also are ready to help in the necessary financial restructuring.

Despite the impact of the downturn, and of course swine flu in Mexico, Latin America contributed over $1b towards Group's pretax profits in 2009. Ten years ago Argentina was in the middle of the peso crisis. But we remained open for business, and we stood by our customers. In 2009 we achieved record profits there. And this year our operations paid their first dividend to the Group since 2001. We also saw strong results in Panama. Loan impairment charges in Latin America began to fall in the latter part of the year. And we continued to reposition our retail business.

We have a small business in Chile. And I'm pleased to say that whilst all our head office building was damaged, all our staff are safe. The Chile Central Bank has asked for the financial system to open today and HSBC Chile will be open and there for our customers in their time of need.

We see Latin America as a region of great opportunity. It's absolutely core to our emerging market strategy. We have chosen to expand our business, not by IPO, but by allocating a further $1.3b of additional capital to our operations in Mexico and Brazil. This will allow us to support the growing economy whilst preserving long-term value for HSBC.

In Europe underlying pre-tax profits increased to $6.6b. In PFS we grew customer accounts and lending. In Commercial Banking we also grew customer accounts, and lending held up well, given the subdued demand. Within our UK new mortgage book, the quality of our portfolio was underlined by a prudent loan to value ratio. Serious arrears were very low, at 0.9%. And our share of repossessions was remarkably low at under 1.5% of the market. Global Banking and Markets performed robustly in Europe, and contributed to a strong performance in France. In Turkey profits were up significantly on 2008.

Now turning to North America. Our operations there made an underlying loss before tax of $4.1b, a significant improvement on 2008. In PFS we grew deposits and we increased Premier customer numbers by 41%. We increased deposits in commercial banking and Global Banking and Markets returned to profit. Our cards business remained profitable in 2009. It's an important asset for HSBC and an important contributor to the value of our core US businesses.

Encouraging as this was, it was our run-off portfolios where we made the most progress. We have done what we said we would do. Since the first quarter of 2007 we have reduced our non-core balances by 37%. In fact the balance sheet of US consumer finance is now getting back towards the same size that it was when we bought the business. In the second half, delinquency balances showed the usual seasonal rise, but the increase was significantly less pronounced than in previous years. As a result loan impairment charges in our run-off businesses improved by 16%.

In 2009 return on equity was 9.2%, excluding the effect of fair value movements on our own debt. Given the current market conditions and proposed changes to capital requirements, HSBC believes the ROE over the medium term is more likely to be around the low end of the target range. Once regulatory proposals are agreed we will publish a revised target range. Our cost efficiency ratio was on target at 47.5%. And our Tier 1 ratio rose to 10.8% above our target range.

In 2010 we expect to see a two-speed global economy. We expect emerging economies to motor ahead, growing three times faster than developed regions. Asia will lead the way and will take an increasingly influential role on the global stage, as indeed it should, not least in the debate about the future and reputation of our industry. Meanwhile the developed economies are stuck in first gear, and still at risk of stalling. This makes our strategy to focus on opportunities in fast-growing markets more valid than ever.

To recap, in 2009 we were profitable in all regions except North America. And in the US we saw an improvement in loan impairment charges. We benefited from our balanced business model. We have built one of the world's top wholesale banks with a predominance in emerging markets. We are the number one international bank and we continue to invest in our franchise in China. We kept lending through the downturn and we built our deposit bases in PFS and commercial banking ready for the upturn. We therefore ended the year as we began, one of the world's strongest and most profitable independent banks, a bank which is dedicated to dividends which declared for the last three years of more than $24b in total.

More than ever, reputation is of vital importance to any bank. It was therefore very satisfying to be recognized as the world's most valuable brand, and hence the number one in the industry. 2009 was also another year which made exceptional demands on our people. It's proof of their commitment that our employee engagement score increased to 71% in such a year. This ranks us notably above the industry average. And I would like to say thank you to all of my colleagues who made such an important contribution to the results we've announced today.

Finally I'm pleased to say that the performance in January 2010 was strong and ahead of our expectations. I look forward to your questions shortly, but in the meantime, back to Stephen.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Mike, thank you. We believe that 2010 will be a pivotal year. The crisis has obviously led to many questions about the future of the financial system. There are a number of decisions imminent in the course of this year. We're at a critical juncture in this debate. And it's one that does require the full engagement of the industry. So before we take questions, I'd like just for a few minutes to pick up on some of the issues that have been making the headlines recently.

The first of them I guess inevitably is remuneration. We've seen widespread and justifiable public anger at the egregious rewards of management failure at some institutions. And indeed over the last three years I've been rather vocal about my concerns on the unacceptable distortions of pay which have emerged in parts of the industry. Distortions ranging from illusory day one payments, without any reference to the tail of risks sitting with the institution, guaranteed multiyear bonuses and so forth.

So I want to take this opportunity to set out our principles at HSBC. And the first one is simply that reward must be firmly tied to sustainable performance. It must be properly aligned to risk, subject to deferral, so that we can see the profitability is real and can be clawed back, at least to some extent, if performance later turns out to be unsatisfactory. Taken together, these measures mean that we can be confident that we aren't rewarding failure. And if remuneration is tied to sustainable performance, then we absolutely believe that bonuses are an effective way to reward employees.

Nonetheless the Board expects fixed pay in banking to increase as a proportion of total compensation, especially for important risk and supervisory functions. This is a process that we have begun at HSBC and do intend to follow through.

Our second principle is that remuneration must be market based. If we're to maintain long-term competitive advantage then there is simply no alternative. If we don't, we will lose some of our best people, or simply fail to attract them in the first place.

To put this in context, HSBC is domiciled in the UK, as you all know. With nearly 300,000 employees in 88 different countries and territories around the world, we simply have to think internationally. And our remuneration policy is no exception.

The third principle is that an independent remuneration committee should conduct rigorous and international benchmarking and consult appropriately as part of the decision-making process. These are the principles that we follow. And that's precisely what we've done this year. The G20 and the FSA have set out clear guidance on this subject, which we support and comply with fully. If anything, we've taken a more conservative line by deferring 100% of the 2009 executive bonuses over three years. We're also completely transparent about our remuneration policy, and one of the very few banks to publish our remuneration report on the day of results.

I believe there's no better management team in banking. It's no coincidence that HSBC has remained profitable throughout the financial crisis, has paid dividends which once again comfortably exceeded bonus awards this year, has not taken any taxpayers' money and has contributed nearly GBP5b in UK tax over the last five years.

A number of our executive Management team assumed additional responsibilities, as you've already heard, late last year or early this year. This year HSBC's remuneration committee reflected these significantly enhanced responsibilities with increased salary awards. This included Mike's salary. After dialog with shareholders, he did not feel it was appropriate to accept this increase at present. But I should make it absolutely clear that HSBC's non-executive Directors have unanimously agreed that Mike's remuneration including salary will be brought up to internationally competitive levels within the next 12 months.

As a matter of broader principle, the Board is committed to the long-term interests of its customers, shareholders and employees. The Board also considers that it's a matter of wider public interest that we ensure HSBC has an experienced, committed management team running what is not only one of the world's largest banks, but one of the world's largest companies. And therefore it is important that our remuneration levels reflect those of the global markets in which we operate.

I now want to turn to another subject, which might not have captured the public's imagination quite as readily, but is if anything even more fundamental to the future of our industry. And that's the question of just what is the appropriate shape and size for a bank. This discussion has taken on the unhelpful mantle, I think, of "too big to fail." Yet the reality is much more complex than these simple headlines suggest. It's important to recognize that for those institutions which failed, corporate structure and liquidity management were at least as important as size per se. Furthermore, to increase long term stability, I firmly believe that the financial system needs banks which are, as you might say, big enough to cope by having diversified business portfolios which help reduce risk and generate more consistent returns.

Likewise there's not been enough consideration given to the needs for banks to be what you might -- as you might describe it -- broad enough to serve. This is especially important in a globalized world where customers have complex, diverse and international financial needs. It is simply undesirable and impractical therefore to prescribe some ideal, simple model for a bank.

Finally, I want to talk about how we make banks stronger. To be clear it is absolutely necessary that we have a banking system that is appropriately capitalized, sufficiently liquid and not overstretched. And getting this right is crucial for us all. In so doing, we have to find the right balance between strengthening the financial system and supporting economic growth. In extremis, taken to the limit, the instinct to de-risk the banking system does of course risk throttling economic recovery. It will also drive risk into the unregulated parts of the capital markets. For some, this doesn't make easy listening, of course. But I strongly believe it is in the collective interest of consumers, individual institutions, policymakers and regulators, that we get this right. Furthermore, action has to be internationally coordinated if we're to effectively manage the risks.

Finally at HSBC we've always believed in having a transparent structure based on separately capitalized subsidiaries. We have a conservative approach to liquidity management, as you know. We have built our business with the scale to provide broad, diversified services to our global customers. The detail and impact of many of these regulatory discussions that are rolling out this year remains uncertain. But we are confident that our focus on the fundamentals positions the Group strongly and competitively to respond to the challenges ahead.

Well, enough from me. Now, let's take questions. Just a bit of procedural stuff. To ask a question, please raise your hand and we'll get a microphone to you. I'm going to invite questions in London, Mike will do the same in Hong Kong. I'd be grateful if you could give your name and the organization you represent before you ask your question. And if I could please ask, one question per turn, that way we can get through as many as possible. Okay, let's take the first question. Mike from Hong Kong, if we may, over to you.

QUESTION AND ANSWER

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

Who would like to start? Silence here. Yes, we've got a question here, here we go. Number three.

Sunil Garg - *JP Morgan - Analyst*

Thanks. This is Sunil Garg from JP Morgan. A question relating to capital and dividend policy. Stephen, you mentioned you'll be resetting the targets or rather, Mike, you mentioned that. Would that have a bearing on the Group's dividend policy going forward?

And related to that, I know it's early days, but how do you anticipate the pressure on new regulation playing out on the Group's need for further capital? Thank you.

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

Stephen, you and (multiple speakers) capital.

Stephen Green - *HSBC Holdings plc - Group Chairman*

Mike, thank you, let me tackle the question on the uncertainties and how we see that playing out. And I'll get Douglas to talk a little bit to our capital generation.

I do think this year is a year of a great deal of uncertainty for the banking industry. You have the Basel Committee has produced, just before Christmas, detailed proposals on risk-weighted assets definitions for various parts, particularly in the trading book. It's talked about capital definitions. They have not yet decided what the appropriate ratios are. They have proposed liquidity parameters. They have talked about leverage ratios, etc. There's some way to go on this, and nobody quite knows how this play -- will play out. I think it is very likely that whatever the final decisions on the bar are, there'll be quite considerable adjustment periods built into the process required by the regulators.

So I think the honest answer is it's very difficult to know at this stage. The safe thing to say is that nobody's going to be required to hold less capital for the business going forward. So far as we're concerned, we don't make predictions, of course. But we are strongly capitalized by almost any standard. And what's more, we've shown by the business results in 2009 that we're capital generative, which we did quarter by quarter all through the year. Douglas do you want to add anything?

Douglas Flint - ***HSBC Holdings plc - CFO, Executive Director, Risk and Regulation***

Yes, I think if you adjust for the fair value of our own debt, which isn't an item that impacts the capital calculations, we paid out in respect of what we declared in respect of 2009 a bit over half of our attributable profit. And if you look at it on a cash basis, which is the way it goes into the capital calculations, you can see on the slide that we generated about $10b of increase in capital from operations and after the benefit of scrip paid out for, so 40%. So I think if you look at our historic pattern, that's pretty much in line with, in fact, conservative against where we've been -- we took the decision to keep the quarterly dividends, the fixed ones, or the intentionally fixed ones at 8% because of the uncertainty and the framework. This isn't -- I don't think it's possible to give a signal at the moment on dividends while the framework is as uncertain as it is.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Okay. We'll take the question from London this time. Alastair?

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

Thanks. First, on the jaws you've been talking about, clearly with interest rates as low as they are and the reference to some of the treasury income likely being lower this year than last, whether that's something that you'd look through when you're considering cost management for the business. Or whether you look to manage the business on an improving jaws each year, even in a year of relatively depressed net revenues, thanks to low rates?

And secondly, possibly to come with the previous question in the opposite direction, unhelpfully, you generated $80b more deposits than loans last year. And the run rate's accelerating, if anything. As you say, you're now generating 50 bps a quarter in free capital. If it's going to take three or four years for Basel to actually implement anything, and you look pretty overcapitalized now and becoming more so by the day, whether -- I invite you to debate in the other direction, that the Group's generating capital it's not obvious you have anything to do with.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Alastair, thank you. Could -- let me get Mike to talk to the first question. And then perhaps Douglas and I might give you thoughts on the second one, although I can pretty quickly tell you what my views on the second question is. It does not feel like a good time to be undercapitalized. But Mike, do you want to talk to the operating jaws?

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

Well, firstly the operating jaws, we look at costs separate to revenue and then put it back together again. The cost base that we're looking at for 2009 was a falling cost base. There were some one-offs in that. But the overall trend that we're seeing is that we are able to make the economies of scale. You need to remember that we've cut our costs in North America, but invested in the emerging markets. We've opened more branches in China, we've expanded in Indonesia and we've increased costs here in Asia. So we're moving costs to the markets that are giving us the best return, but keeping costs pretty well flat across in the process. Is this sustainable? It's going to be a challenge. But some of the things that we are -- have got in the pipeline for One HSBC should give us a strong advantage going forward.

Your point about deposits, yes, you're right, we're raising more deposits than we're lending. But that's frankly a signal that we've probably got one of the strongest brands in financial services. And people want to put their money with us. And I think you'll find that frankly it'll get even bigger. Because as the guarantees come off the banking systems, the local banking systems in regard to local banks' deposits, they're more likely to get more deposits. I think the element where we've got to get to, particularly in Asia, is that borrowers have to be more confident to invest. I can see signs of that beginning. Clearly the factories in China are at pretty well top-up capacity, freight costs are going up. So there's indications there's a bit of competition out there. And I think you're going to see a few quarters of that, and certainly in Asia you're going to see more investment. And I think that is where you'll find that liquidity used up.

But we're cognizant of the fact that we have a lot of liquidity. I think it's the wise thing to have. I don't think -- there's nothing wrong with 19th century banking systems where you take deposits first and then you lend.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Douglas, do you want to add anything on the capital front?

Douglas Flint - ***HSBC Holdings plc - CFO, Executive Director, Risk and Regulation***

Just a little bit. I think it's all about the platform. One of the good things about the deposit growth is I think there's no question in the regulatory changes that will happen there will be much more compartmentalization of liquidity. And therefore the capacity to lend is going to be heavily dependent upon having a pool of deposits. We happen to be very successful at growing deposits in the part of the world where most credit demand is going to arise, growth-related, which is Asia and the other emerging markets. So to build our capacity when in fact there may indeed be constraints in other people shipping liquidity in I think is a good thing to do.

And if there's a lull before that happens, as we all expect the next move in interest rates is only going to be up. And therefore the value of our deposits will progressively rise. So for both those reasons I think continuing to build a very solid balance sheet is positioning ourselves for a changed environment rather than for the one that we have today.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Douglas, thank you. I wonder if we can take another question from Hong Kong, Mike?

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

Yes. Number four.

Roy Ramos - ***Goldman Sachs - Analyst***

Morning, Roy Ramos at Goldman Sachs. Could you give us some color or clarification on the significant negative movement on the insurance side? I'm referring to the Group P&L where your net earned insurance premiums on a year-on-year basis were flat or down a bit, but you had a huge swing factor on the net insurance claims incurred and movement in liabilities of about $5b. And I'm not an insurance expert, but again if you could just give us some color, because it's a huge P&L swing. Thank you.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Roy, thank you for the question. I share your view that insurance accounting is one of the hardest parts to understand. Douglas, over to you.

Douglas Flint - ***HSBC Holdings plc - CFO, Executive Director, Risk and Regulation***

I was expecting that, thank you. Actually, Roy, in the accounts, page 31 to 34, the offset to the rise in insurance claims and amounts attributable to policyholders is largely above the line in assets measured at fair value where essentially assets held to back investment contracts and insurance contracts held at fair value, as they rise in value as they did this year with equity markets recovering, the benefit goes to policyholders. So in fair value we make a whole bunch of gains and in amounts due to policyholders we effectively attribute them to policyholders. So the net is very, very small. There's no big swing that goes to the P&L account. It's income in on the fair value and across some of the other headings in revenue and then going out to policyholders on the other side.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Question from here. Yes, please?

Ian Smillie - ***RBS - Analyst***

Thank you, it's Ian Smillie from RBS. Two quick ones, please. One on the numbers. If we look at first half, second half, with revenues going down and costs going up, it looks like the pre-impairment profit excluding the fair value of own debt, is something like $17b in the second half of the year. So I guess the question is are you guiding us to any sense of growth in that number until interest rates start rising in the US? Or are we running at a -- is that a better reflection of steady state?

Douglas Flint - ***HSBC Holdings plc - CFO, Executive Director, Risk and Regulation***

We never knowingly try and guide you. I think we definitely did guide you last year that the first half was exceptional in terms of balance sheet management. And there's always also a seasonal impact in the second half because of the August and December period. And as you all know, trading volumes and so on began to pair off in the fourth quarter. So there's some element in global banking and markets on the revenue side that was first half oriented. And that was clear from their numbers, and you saw that.

I think in the core commercial and personal businesses there was an improvement in the bad debt line in the second half, largely because a lot of things had been addressed and the US books began to run off.

The revenue line is really very dependent upon three things. Interest rates for deposit margins, a recovery in sentiment to equity products, so that the wealth businesses kick in a bit more. And then what we do on costs. And I think at the moment, there's still a relatively muted -- sorry, the other thing is demand for credit, which there isn't very much of, although we've done well in mortgages. So there's a somewhat muted picture in terms of revenues acknowledged at the moment. I don't know whether Stuart or Sandy want to add anything to that?

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Stuart?

Stuart Gulliver - ***HSBC Holdings plc - Chairman of Europe, Middle East and Global Businesses***

Yes, sure. The -- we have signaled actually for quite some time that balance sheet management would run down. And a decline in balance sheet management and actually in the rates line really explains the 22% fall in Global Banking and Markets second half versus first half, although I would point out that the second half of '09 was still higher than the first and second half of both '07 and '08. So we've settled back in the second half of '09 to a level above '07 and '08 each half.

There is also therefore probably a sense to get to a balance sheet management number that's more towards the 2008 type of level than what we saw in 2009. And we've been consistently guiding you, as it were, that that would run off, because the positions were taken 2007, as Mike said and they tended to be, in essence, two and three year positions. And they were taken at a time and you all remember in September '08 actually the UK CPI was actually at a ten year high. So they were taken way before it became obvious that interest rates would fall. And we were still in the moral hazards high elevated CPI environment here in this country.

So BSM will be lower. But the other thing to bear in mind is if interest rates start to rise we'll make more money in security services and PCM. And we're also obviously continuing to invest in various other businesses in the global banking markets. And it's also true to say the loan impairment charges on the other hand are unlikely to repeat. By definition there are some loan impairment charges there where the exposure has been significantly written down and you obviously can't write it down a second time. So that actually in a way is a positive. It's not going to repeat as a negative. It's really all I think on Global Banking and Markets.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Thanks, Stuart, thank you. Mike, do you want to add anything or does Sandy? If not, then perhaps another question from Hong Kong.

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

Sandy wants to say something about Commercial Banking. Sandy.

Sandy Flockhart - ***HSBC Holdings plc - Chairman, Personal and Commercial Banking***

Commercial banking and I think Personal Banking, there was strong growth in these numbers, in customer numbers and in deposits. But the value of that has not come through because of the interest rate environment. But that bodes well for the future.

And the other issue I think, the other big swing factor that you've got there is loan impairment charges. And loan impairment charges in the retail businesses was really, second half '08, second half '09 were on similar sort of levels in fact. So the issue really is coming through to 2010 are we going to see a large drop off in loan impairment charges, notwithstanding the low interest rate environment that will compensate and make up for some of that growth coming forward. Or are loan impairment charges going to remain at a high level.

I think, as Mike said, in January we had strong results ahead of expectations. So I think you can come to your own conclusions on, directionally where these businesses may be going. But there is strong growth in these businesses across all the retail sectors. But the value of that in a conservatively run balance sheet, that hasn't got much leverage at the present moment and with muted loan demand, it's not there. But it should come through.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Sandy, thank you. Another question, Mike, from Hong Kong?

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

Number one.

Bill Stacey - ***Aviate Global - Analyst***

Bill Stacey from Aviate. In the US consumer finance businesses I wonder if you could talk through where you're at operationally in terms of cost reduction from the consumer finance infrastructure, and where that operational reduction in your footprint in cost is relative to the numbers that we see in terms of the cost reduction in the US? And how long it will take before you get to more or less normalized cost levels.

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

Stephen, I'll take that one if I may. The -- I guess -- this is a very important point because I think some of you when you were doing your calculations, you could see the impairment charge coming back, but you didn't calculate in the revenue's got to go as well. And equally the cost, how much of the costs are deductible or are able to be reduced and how many need to be kept. Well, the fact is we're not producing any new business in the run-off portfolio. So we're managing down core numbers of customers.

But the cost of running those customers, be they restructuring their facilities or paying them off, hasn't changed. So the cost base for collections, if anything, has gone up. And obviously things like advertising have come down, staff numbers have come down. But will they come down significantly more? Yes, they will. We've got a number of centers around America. And the team in America have frankly, I think last year they virtually closed a center a month in different areas. I think also in some of those portfolios we've taken the opportunity to sell the portfolio. We did the -- we sold the platform for auto finance. Now we'll probably sell some of those portfolios as the opportunities arise.

So, on the revenue side I hope we'll get to stability. And the net margin of that business still looks attractive when you look at the competition in the States with the amount of liquidity they've got. And I suspect there will be a knock on the door at some time from somebody wanting to buy portfolios to put together with their own portfolios to get the cost advantage. We can't see us having the cost advantage in the short term. But we'll certainly manage those costs in a very opportunistic way, and we're doing a lot more processing overseas, etc. So we're quite good at managing costs, and the US is no exception.

Stephen Green - *HSBC Holdings plc - Group Chairman*

Mike, thank you. A question from here. Simon, you've been very patient.

Simon Samuels - *Barclays Capital - Analyst*

Thanks. Good morning. It's Simon Samuels from Barclays Capital. Could I have a couple actually? Just one strategic, one on numbers. Just on the strategy. Congratulations on hitting 500 pages of disclosure. I think it must be a really proud moment. There's not very much in there on insurance. And I think a lot of people would assume that you'd have been interested in the assets that Prudential's announced they're buying today in terms of the geography and the business mix. So maybe you can just talk about whether insurance is maybe being deemphasized within the Group, and particularly whether that was an acquisition that you were interested in. And I've got a second question on numbers.

Stephen Green - *HSBC Holdings plc - Group Chairman*

Do you want to fire both questions --?

Simon Samuels - *Barclays Capital - Analyst*

Well, the numbers question is very simply about the margin over the course of 2010. I think if my math is right, it looks like your net interest margin gapped down by about 30 basis points during the course of the second half of the year, which is pretty much the biggest move I can ever remember it doing in a six month period, other than the period you bought Household. So can you just kind of talk about the moving parts for margins for 2010, the interplay of rates and BSM and everything else coming together.

Stephen Green - *HSBC Holdings plc - Group Chairman*

Simon, thank you. What I'd like to is get Douglas to take the second question first, then I'm going to pass it over to Hong Kong for Mike to talk about insurance strategy, and then follow that up with a question at that end, Mike.

Douglas Flint - *HSBC Holdings plc - CFO, Executive Director, Risk and Regulation*

And if you can't sleep pages 265 to 283 in the book have a very full explanation of our insurance business.

Net interest margin, the big impact in the second half is balance sheet management clearly, because we were losing revenue without losing the size of the balance sheet. So I think in the PFS and Commercial Banking businesses the expansion we saw through '08 and into early '09 in relation to repricing upwards has probably drawn to an end. There's a lot more competition, plenty of liquidity in the marketplace. And the benefit to margin I think is going to come progressively through mix as we downsize, run off assets that are non-performing in the United States, and keep the lending roughly the same but which has led into yielding assets, and secondly, from deposit margins as and when rates begin to rise.

But it's really a rates story. I don't think the balance sheet and credit is going to grow dramatically, but it is going to have a mix impact away from the run-off books into books that have good margins in the business that we put on. For example, where we did see opportunities to grow was predominantly in mortgage assets both in Hong Kong and in the UK particularly. And the margins on that business was good. But you're talking relatively light and with a rising impairment, we're getting a drag from non-performing loans to some extent. So it's going to be a mix, and it's going to be deposit margin I think.

Simon Samuels - *Barclays Capital - Analyst*

If the rates don't go up this year in your major geograpies, is the new level that we saw in the second half of 2009 is that now the new base essentially, because the BSM sounds like its going to be a slow drag...

Douglas Flint - ***HSBC Holdings plc - CFO, Executive Director, Risk and Regulation***

I think as Stuart said it's true that BSM is going to be, relative to history, we think still very good but -- first half of '09 was particularly good. But apart from mix changes, I think you're right that, absent rate rises which will help us in deposit margins and indeed in costs today and in payments in cash management, the revenue picture in net interest margin is going to be purely mix and volume.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Simon, thank you. Can I, Mike, invite you to talk about insurance strategy?

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

Well, firstly on the AIA opportunity, I believe that HSBC should focus on distributing insurance products. The only place where we have critical mass in manufacturing really is here in Hong Kong where two-thirds of all policies are sold by HSBC. If you went to something like AIA, you'd switch the whole mix of the Group to such a level that we would be very -- emphasizing insurance to the possible detriment of our banking business. I think insurance should be part of the products we distribute inside our banking core, but banking should remain our core. And clearly obviously in this region we've got Ping An that gives us a fantastic entry into the largest market in the region being China. And I think that is the right place to play insurance in the region.

We are reviewing distribution in different places. We do look to see who we use to distribute our products. We are looking at some of the manufacturing around the world. We actually did dispose of some units of manufacturing during the year. But insurance plays an important part of our wealth management strategy. How we execute it is important. But I think frankly we would not be the party for AIA. But interestingly we are the investment banking partner for that transaction and shows that we are in the right position here in Hong Kong with regards to investment banking. I can only see that building out more, as Stuart gets his team together here in Hong Kong and in China.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Mike, thank you. Would you like to take another question from Hong Kong?

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

I'm looking for one. Nothing here at the moment so I'll go back to you.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Tom. Over to you.

Tom Rayner - ***Barclays Capital - Analyst***

Yes, thanks very much. It's Tom Rayner from Barclays Capital. Could I ask Stuart, on slide 63 which is your breakdown of operating income slide, you've spoken about BSM first half, second half and given us some guidance. Could I push you just on some of the other highlights, second half versus first half? It's not very easy to see from the slide. I think ex BSM, revenue was down 15% in the second half. Could you just comment on what the key second half moves were, and where you can give us a feel for what we should be thinking about going forward, both market share and also absolute performance?

Stuart Gulliver - ***HSBC Holdings plc - Chairman of Europe, Middle East and Global Businesses***

Yes, absolutely. Thank you. So the things that declined first half, second half, which obviously you can do quite easily, so let me give you the numbers. Foreign exchange was $1.8b in the first half, $1.2b in the second. Credit was $1.1b in the first, $1.3b in the second. Rates was $1.96b in the first and $700m in the second. So rates is one of the big falls. The rest of it's all kind of much of a muchness, and then balance sheet management. So, the real big things are FX fell, rates fell and balance sheet management fell.

Now to put that into context rates had an extraordinary first half, $2b compared to second half of '08 $730m, first half $1.3b, second half of '07 $700m, first half of '07 $600m. So in a way we've got back to the -- the second half of '09 identical to second half of '07. Put aside '08 as being an exceptional year. So it's -- I don't -- I think what you need to look at is that the first half of '09 was an exceptional number rather than the second half of '09 being an exceptional problem.

And in the foreign exchange numbers again they're back at where we were running in 2007. And I think everyone has seen, and the banking survey has shown that the turnover in the market has fallen about 30%, the foreign exchange market. I think we've probably preserved our market share because of our large emerging market footprint. But that trend of slow down in foreign exchange volumes has been predominant in the industry.

So where do we think the growth comes from, which I guess is also part of your question. Well, I think that, as Mike said, we have seven businesses that make over $1b of revenue, put aside balance sheet management there's six of them. There are two others that can get to that $1b number. One's asset management. And here in the UK, the team in the UK bank has managed to sell over GBP1b of World Select, that asset management project that we've now joined up with the Retail bank and sold. So there's good momentum there. And actually in equities we can get to $1b. And as Mike remarked, we're one of the three banks that is underwriting the Prudential rights issue. You saw last year we were involved in a number of financial institutions transactions, so there's some serious momentum there as well.

And then also the wealth opportunity is significant here in the UK and in Hong Kong. And we're also building out in Prime Services. And also I think there's a big opportunity for us in what we describe as kind of south, south, so emerging market to emerging market, where I think HSBC's footprint is very uniquely positioned compared to a lot of our competitors. So overall 2009 was a record number. And let's not forget, the second half was bigger than any of the halves of 2008 or 2007. So I wouldn't get too negative about the second half.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Stuart, thank you. Robert, did I see that you had your hand up? And then we'll go back to Hong Kong after.

Robert Law - ***Nomura - Analyst***

Could I have a couple of quick questions too please? Firstly on the region Asia ex Hong Kong, which was certainly a bit below our expectations, and it's down year on year. And I wondered what you think it would take to particularly to change that. And in particular, within Asia you've grown the Chinese loan book very aggressively in the second half of the year. Could you comment about where that is and what you see as the prospects for that?

And the second area is HSBC Finance. You've seen a reversal of the trend in the last few quarters of the credit charge coming down and it started to go up in Q4. Could you comment on the outlook for the run off businesses please?

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Thank you. [Douglas], do you want to pick up on that last point, just on the numbers, and I'm going to ask Mike to talk to the rest of Asia.

Douglas Flint - ***HSBC Holdings plc - CFO, Executive Director, Risk and Regulation***

In relation to the run-off businesses, I think that there are three drivers to impairments. Obviously, the size of the book, the trends in deterioration and the severity of loss. I think that the good news in a sense, in what is obviously still a very uncomfortable business, is the book continues to run down fairly steadily, slowing a bit now because refinancing opportunities are lesser, but still running down. The actual evolution of impairments is stabilizing. And within that evolution, the severity is stabilizing or gets -- stabilizing in real estate, and second lien lending is much less as a proportion of the book than it was two years ago, three years ago when we went into this.

So I think one of the positives in '09 is if you look at the severity of loss on foreclosed properties it's been around 51%, 52%. In fact it ticked lower in the third quarter because of the tax incentives in the US and then it ticked back up in the fourth quarter. But it's a pretty stable picture. So there's been no incremental provision for severity, relatively stable in terms of evolution and the book is coming down. So all of those factors are quite good.

But we're certainly not sitting here saying we're declaring victory or anything like it. It depends how the economy evolves through 2010. But so far it continues to perform well within the context of well, meaning not getting worse and probably a little bit better than expected still.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Mike, do you want to talk about rest of Asia, you or Sandy?

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

I'm actually going to let Peter as the Chief Executive of the Asian operations. Peter, you're on.

Peter Wong - ***HSBC Holdings plc - Chief Executive Asia Pacific***

If you look at Asia, I think, in the first half of 2009 the economy wasn't that good but the economy rebounded a bit in the second half of 2009. We were affected by the low interest margin on the deposits. The AD ratio in Asia Pacific is 43.8 which means we're very long in liquidity. That's why the impact on the low interest margin. But going forward we have a strong capital of 16.1%, AD ratio 43.8. That means that we can expand our balance sheet.

As far as the 2010 is concerned, we can also see that GDP in Asia Pacific, ex Japan, is going to be in excess of 7%. So that would give us pretty good opportunity.

As far as China is concerned it's pretty much the -- it's growth in the asset book across the board but also more on mortgages. So we have been growing mortgages in the last few -- in the last half of 2009.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Peter, thank you. Mike, do you want to take a question from Hong Kong?

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

We've got one here now, number four.

Alistair Scarff - ***Bank of America - Merrill Lynch - Analyst***

Thank you. It's Alistair Scarff from Bank of America - Merrill Lynch. Just a quick question if I can relating to a comment in one of your notes about the acquisition of potential portfolios as potential exiting parties leave markets which no longer seem attractive. Could you give some color as to what types of loan portfolios they may be, i.e. types, would they be mortgages, commercial, corporate and potential geographies which you're seeing at this point in time which may seem more attractive? Thank you.

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

Well, actually I don't think there are that many yet to come. I think the fact of the matter is there are a number of finance house banks that will need to reflect on their presence in multiple countries. I mean there's clearly people going back to home bases and going back to fundamentals. Sandy's team in Commercial Banking, we said that 60% of the new business was coming out of emerging markets and the reality is that we are probably one of the few players in the world that can give an international service across 88 different countries. And we're focusing that effort and that strength in that area. Obviously there are some other parties that wish to sell off portfolios, but it wouldn't be right for me to comment on those parties themselves. But then it's generally actually just being open for business when others are not. And that's what we're working on.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Mike, thank you. Question from here? Yes, please.

Leigh Goodwin - ***Citigroup - Analyst***

Yes, good morning. Thank you. It's Leigh Goodwin from Citi. Actually a question on capital and foreign exchange movements. I wonder if you could just tell us what the sensitivity is in the capital number to movements in the pound against the dollar. It struck me that the number came in at the end of the year at 9.4% rather better than I expected in the core Tier 1 ratio. And I wondered how much of that was due to the strength currently of sterling towards the end of the year. And then, of course, what the effect would be of the reversal that we've seen in the last two months.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Yes, thank you. Douglas, that is one for you.

Douglas Flint - ***HSBC Holdings plc - CFO, Executive Director, Risk and Regulation***

We're relatively -- there's some sensitivity to FX rates, but essentially the policy is to hold net assets by currency in line with risk-weighted assets by currency, so that the two move in parallel. There is some noise but it's actually relatively modest. So that would not be a major impact.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Yes, you've been very patient.

Arturo de Frias - ***Evolution Securities - Analyst***

Yes, thank you very much. Arturo de Frias from Evolution. I also wanted to ask about capital, because it is clear that the core Tier 1 ratio is higher than what most of us were expecting at 9.4%. But I still see a number of adjustments that could bring that ratio quite significantly down in a worst case Basel scenario. There are still around $10b of AFS losses that could be deducted. There are still more than $11b of insurance investments that could have to be deducted. You have still around $6b or $7b from DTAs. You have the minorities. You have around $4b from the shortfall of provisions versus Pillar 3.

So obviously the range is quite wide, and we don't know because, as you said, the capital rules are just a proposal. But I would say in a best case scenario we're probably talking about close to $20b of potential adjustments. In a worst case scenario it could be around $35b to $40b. And that would obviously take the capital ratio to well below 8% or even below 7%. At the same time you have mentioned that you could lower your guidance scenario -- which obviously -- but keep the dividend, which obviously means less capital retention going forward. So one has the impression in a worst case scenario you would struggle to fund your growth and still keep the core Tier 1 above 8%. So could you comment on what you would do on a worst case scenario from Basel? If you could put that in connection with a potential listing in Shanghai if you're going to take that opportunity to top up a bit the capital? Thank you.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Well, let me start this off but then I'm going to turn it to Douglas. Two -- one general and one specific point. Listing in Shanghai, you shouldn't think of that in the context of the Group capital position. And we've been very clear on this, that if we list in Shanghai it's because the authorities allow international entities to list there. We would be keen for all sorts of obvious reasons because it's demonstrating our commitment over a long term to our business in what is that all-important market of the Mainland.

I have to say this is a matter for the authorities. I do not know the timing, but we certainly wouldn't be approaching this with the thought that this is a great opportunity for raising a lot of capital. That's not the way we will be thinking about it. So I don't think you should factor that into the question that you're asking.

Let me make one general comment on the Basel process and then I'll turn to Douglas to talk about the numbers. I think it is extremely unlikely that the outcome of the Basel process would not only be the most extreme version of the deductions but also no phase-in periods. I think that's extremely unlikely. All of the noise at the moment is about phase-in periods that are quite long, five years plus. And I think that they are very conscious of the implications for the banking system generally of getting this wrong. What you said about us, there are -- you will have analyzed in respect of a whole number of other banks. And it's very clear that they are simply -- that they will not, I think I would go as far as to say that, they are not going to simply impose the most extreme version of the proposals and also no phasing over quite a long period of adjustment. Now, Douglas.

Douglas Flint - ***HSBC Holdings plc - CFO, Executive Director, Risk and Regulation***

I agree with everything Stephen said. In relation to that I think two or three things. One, as Stephen says, the framework changes are still very much up in the air for debate. Two, I think it's important to reflect that there would be a path towards achievement. But at the moment of course there's no calibration in terms of what the new measure would be. And some of the changes simply give a better insight to what is already existing fact. I mean changing what is included and not included doesn't change the quality of capital. It's just a different prism through which to look at it.

You can actually get most of the numbers straight off the accounts in relation to deferred tax or so. And I'm grateful for the chance to make two comments. One, we've enhanced our disclosure a little bit because as we saw people doing analyses of Basel III, the famous AFS reserve has had a multiple of treatments. So we've tried to make it clear, and you see in page 289 when you look at the capital movements --

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Stephen Green - ***HSBC Holdings plc - Group Chairman***

Assuming you've got that far.

Douglas Flint - ***HSBC Holdings plc - CFO, Executive Director, Risk and Regulation***

It's supplemented by footnote 74 on page 294 that the AFS reserve splits between the -- the vast, vast majority of it, 90% of it is in relation to non-consolidated entities. So therefore even if the AFS reserve had to be deducted from capital, those entities are not brought into the regulatory consolidation. So it doesn't have an impact.

The other thing to say on deferred tax, and again we've split the deferred tax in the accounts to show you where the deferred tax, gross deferred tax assets arise which is predominantly the US, Latin America, UK and then spread all over the place, is that the biggest piece is in the United States. And that asset substantially already does not count for capital within the US capital calculations. So while there would be an impact on the Group's capital ratio were deferred tax assets ultimately not to be included in Basel II capital, in relation to would we need to put more capital into the United States, the answer would be no, because already it's substantially -- not completely, but substantially deducted in the US calculation under US rule.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Mike, any questions from Hong Kong?

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

I'm just checking. Yes, one question, number three.

Sunil Garg - ***JP Morgan - Analyst***

I just wanted to ask a question in relation to the Middle East and Mexican provisioning. Is there any element of reserve build up in the provision numbers in the second half? Thank you.

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

Well, let me take this because otherwise we'll have two people talking on it. On the Middle East, clearly the second half has been more challenging. Have we been tough on ourselves? Yes, I suppose we have. It's our hallmark to do that and we do take provisioning fast and to the point.

I mean the reality, as I said in the comments, is we are very supportive long term for the Middle East. I mean the oil reserves of the world are there. The ability to finance and restructure in Dubai, for example, is not without the realms of the region doing it itself. And I think there is a real opportunity to stand firm and take market share in that region. And Stuart's now running it. He's got experience of it. So have I, I started my career there. We know this business. We know the people in it. And we're there to assist. So I'm saying taking provisions, taking them hard, going to be opportunities and there will possibly be some recovery somewhere along the line.

In Mexico that's a different situation. You've got to remember two things in Mexico. We've got a liability-led business. When we bought it, we had deposits on one side and we had no real assets on the other. We built out those assets. They're maturing now, particularly card assets, unsecured lending. And we took some heat in provisioning there in the first half of the year, coming much better in the second half. And also remember the first half that we had the flu virus and things in Mexico. And business did suffer. And suffer obviously for a raft of reasons. But for all those reasons, growing out the book, by domestic issues and international issues, it was a tough year for Mexico. There's no getting around it.

But we believe that we've got the business well structured. We have taken provisions up level. We're bringing the synergies together. We've got one head for Latin America based in Mexico bringing together all the different elements of our Latin American strategy -- and I think you'll see, both in the cost side and the revenue side, some improvements going forward.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Mike, thank you. Any questions from here? Please. We're probably down to the last couple of questions.

Michael Helsby - ***Bank of America - Merrill Lynch - Analyst***

Thank you. It's Michael Helsby from Bank of America - Merrill Lynch. Just a quick question on strategy and particularly in the UK. As I look around the globe at your operations, the UK is one big region where you've clearly got a lot of competitive advantage, from a funding perspective, relative to peers. So it's just that -- the question is what growth opportunities do you see in the UK to see that from a competitive standpoint?

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Michael, thank you. What I'd like to suggest, Paul, can I put you on the spot. We have the CEO of our UK business sitting in the front row. If we can get him a microphone?

Paul Thurston - ***HSBC Holdings plc - Chief Executive UK***

Thanks very much. If you look at our 2009 results in the UK Retail business, clearly we were hit by higher loan impairment charges. We also saw deposit margin compression. Our AD ratio here is well below 100, unlike any of the other UK banks. That's caused us some reduction in net interest income in 2009, but clearly, as interest rates rise, that gives us some potential in the future.

I think our competitive advantages come firstly from our Premier customer base. We've continued to build that. We grew our Premier customer base by 22% in 2009. And our ability to bring the world of investment services, insurance propositions to our retail customers. So I think that's one real competitive advantage.

In the Commercial space, I think it's our international business that gives us the opportunity to help UK companies that are trading and operating internationally. So I think we have a number of strengths in the UK that we can continue to build on.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Paul, thank you. Mike, in Hong Kong do you want to add anything on UK strategy, and then perhaps take one last question from Hong Kong.

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

Well, our strategy for the UK is obviously integrating with our business around the world. As Paul said, there's a lot of opportunity in the commercial banking space. And Sandy and his team are working on that. I think Premier is sensible. I think you've got to build a real base. If you look at some of the client bases of the other banks, they haven't got the age advantage that our bank profile of customers are. They're very much more international, educated to a higher level in many areas. So their aspirations for life are higher. And hence I think the quality of the customer base will benefit from what we're offering to them as we go forwards. Otherwise, it's a good long term business for us. And it's a reflection that we're both in the emerging markets, but also in the developed world.

Any other questions here in Hong Kong? No, Stephen, nothing from Hong Kong.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Right. Well, a chance for one final one here. John-Paul?

John-Paul Crutchley - ***UBS - Analyst***

Morning. It's John-Paul, JP from UBS. It's a question actually specifically for Mike. Mike, I appreciate it's been fairly short dated so far, but now that you're on the ground in Hong Kong, I wonder if you can just reflect on what that has changed in terms of your perspective, in terms of how you think about Group strategy. And whether you're now more confident that you can change things or accelerate things, and whether it's organic or inorganic from being there on the ground. Just your reflections please.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

John-Paul, that's a great question. Mike, good one to draw the meeting to a close on.

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

Well, thank you, John-Paul. The reality is being on the ground makes a huge difference. The fact of the matter is you're living the economy, our largest economy where we've got our operations, we're able to make decisions in our time zone. We're able to build out the business and make decisions. It is early days yet.

From a management of the business globally, there was always that comment made that the bank would split itself into two. There would be the developed world business in London and the emerging markets business out of Hong Kong. Well, that's not happening. Stuart and Sandy and Douglas and myself, we talk every week formally by telepresence. I'm in London every month. In fact I would say the team's in the best shape that I've seen it since we got together as a team. And I think we're pretty switched on to where we need to do things. And running it from Hong Kong just makes sense. And I think everybody helps each other to make it work.

Obviously there's a lot of travel involved but that is no different to what was going on in -- from London. And I think this is the right thing. It feels right, and I think the pace of the bank here in Hong Kong is certainly moving forward. And I think it will only increase as the opportunities arise. And we also recognize we're going to have a lot of market competition in Asia. Everybody's coming here, but it's best to have the Group CEO on the ground to make those decisions there and then, rather than others have to go back to their headquarters. Stephen.

Stephen Green - ***HSBC Holdings plc - Group Chairman***

Mike, I think that's a good note to end on. Thank you very much for being with us this morning here in London, this afternoon in Hong Kong, for all the attention you pay to HSBC. Look forward to seeing you at the interims. Thank you.