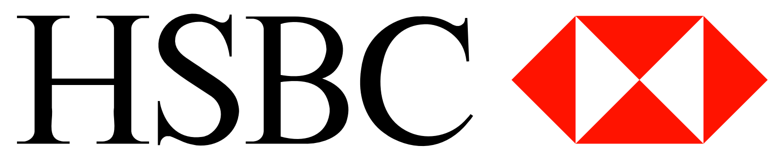

The world's local bank

HSBC Holdings plc 2010 Annual Results

Conference call transcript

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PRESENTATION

Douglas Flint *- HSBC Holdings plc - Group Chairman*

Good morning from London, good afternoon to those of you in Hong Kong, and a very warm welcome to everyone who's joined us today. I'm Douglas Flint, Group Chairman. With me are Stuart Gulliver, Group Chief Executive, and Iain Mackay, Group Finance Director.

For these results presentations we intend to alternate between London, where we are today, and Hong Kong, where we're going to be in August. We've taken the opportunity to move to a webcast format, in line with many global companies, in order to give everyone equal access, no matter where they're located.

For those of you viewing the presentation, please can you take a moment to read the usual cautionary words on your screens now. And for the avoidance of doubt, all dollar figures given are US dollars unless otherwise stated.

In a moment, I will hand over to Stuart and Iain to take us through our performance for 2010. Before I do, I just want to set the context for these results.

When I became Chairman three months ago, I was acutely aware of the significant challenges our industry faces, not least in balancing the many different demands of stakeholders, including our customers, investors, regulators, staff and the public. Above all, I was fully conscious of the importance of HSBC building sustainable, long-term value for our shareholders.

So I'm pleased to report that our performance in 2010 was much improved and better balanced. All customer groups and regions were profitable, including North America. And HSBC continued to generate capital during the year, leading to strengthened capital ratios and an increased dividend. All this is encouraging for shareholders. It also positions HSBC well for the evolving regulatory environment, and I will offer a perspective on that particular subject later.

But first, over to my colleagues, starting with Stuart for the financial highlights. Stuart.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Thanks, Douglas. We plan to set aside a dedicated day for analysts and investors in May, to give strategy the full attention it deserves. So, today, we'll focus on our 2010 performance only.

On a reported basis, pre-tax profit more than doubled to $19b. And recovery continued on an underlying basis, with pre-tax profits ahead by 36% to $18.4b. The main driver behind this strong improvement was lower loan impairments in all regions. However, revenues also benefited from strong momentum in Asia and in global trade.

But to be crystal clear, we still have some way to go to achieve satisfactory levels of profitability, and in particular cost efficiency, which was unacceptably above our target range. We're now taking focused action to deliver this, as I shall outline later.

Earnings per share did improve strongly, and ROE increased to 9.5%. We also strengthened our Core Tier 1 ratio by some 110 basis points, to 10.5%. And this allowed us to increase the final dividend by 20%, and bring the total dividend for the year to $0.36 per ordinary share. And we also increased the first three interim dividends planned in respect of 2011 by 12.5%.

I'll now hand over to Iain, to cover financial performance as Finance Director. Iain.

Iain Mackay ***- HSBC Holdings plc - Group Finance Director***

Thanks, Stuart. Starting with the reported results, I would highlight three main points. First, the very significant reduction in loan impairment charges, which fell to almost half of 2009 levels. Second, an increase in costs, which I'll return to later. Third, the reversal of the movement in fair value of own debt relating to credit spreads, where we saw a negative movement of $6.5b in 2009, followed by a much smaller negative movement of $63m in 2010.

Looking at the numbers on an underlying basis, in a period of sustained low interest rates, revenues were lower due to four main factors, reducing loan balances in our US consumer finance business, lower trading income in Global Banking and Markets, notably in credit and rates. This resulted from lower client activity following increased uncertainty in the euro zone. Elsewhere, this was compounded by a $2b adverse movement from non-qualifying hedges. And we also saw a reduced contribution from balance sheet management, as we had forecast.

This was partly offset by two factors, continued recovery of trade related income and lending volumes, mostly in emerging markets, and growth both in our insurance business, where income was up 16% overall, and in asset management. This was particularly notable in Asia.

On an underlying basis, costs rose by 8%. Looking at costs in more detail, significant one-off items accounted for about a quarter of this increase, in particular the combined effect of pension benefit adjustments in 2009 and 2010, together with the UK and French bonus tax on the 2009 payroll recorded in 2010, which was around $700m.

Excluding one-offs, costs increased by 6%, with four main drivers. We built out the business in areas we had signaled, notably in Global Banking and Markets, including Prime Services, equity capital markets and our electronic platforms in rates and FX. Staff costs were higher, as we continued to build future revenue streams and improve customer service. This reflected the recruitment of staff, compounding the inflation of compensation costs in Asia and Latin America.

We increased marketing spend to support business development generally, especially in emerging markets. And we saw higher regulatory and litigation costs, mainly in Europe and the US. This included the recruitment of support staff in London and other regional offices, in response to the changing regulatory environment.

Comparing performance between the two halves, the second was the weaker, with European sovereign debt issues impacting market activity levels more significantly in the second half. Cost growth also accelerated in the second half in each of the areas I have mentioned.

Within our underlying results, I would draw out a number of significant factors, taking the income line first. As I mentioned, we have economic hedges in place in a number of areas, principally to economically hedge fixed rate debt issued by HSBC Holdings plc and to hedge the increased duration of the mortgage book within HSBC Finance. These do not qualify for hedge accounting and have generated an adverse change of $2b between 2009 and 2010. However, this has no impact on expected cash flows or on our economic performance.

In terms of impairments, you can see the improvement in the AFS debt and equity securities portfolios, which led to a positive swing of $1.3b as a result of a slowing rate of anticipated losses in the underlying asset pools.

I've touched on the one-off cost items already.

Finally, in the tax line, we highlighted at the interims the effect of the sale of HSBC Canada out of the US Group to the UK. And we observed a normalization of the effective tax rate year on year, in line with the changing geographical profile of profits.

Let's now look in more detail in the improvement in credit quality. This slide shows the particularly strong improvement in Personal Financial Services. Loan impairment charges were lower in all regions. The largest dollar decline was in the US. In cards and retail services, we saw lower balances as customers paid own debt and experienced lower delinquency rates.

We also benefited from reducing balances in the run-off mortgage and personal finance portfolios, which proceeds largely as expected, although the US residential property market remains in a distressed state. We recorded significant declines in Latin America and the Middle East too, where we managed down certain high-risk portfolios. I'd also note in passing the strong credit experience in Asia and Europe generally.

In Commercial Banking, there were also declines in all regions. Again, you can see the strong credit quality in Asia, where we grew lending significantly last year.

In Global Banking and Markets, both loan impairment charges and AFS impairments were considerably lower. In the AFS portfolio, the reserve continued to reduce. Impairment charges in the year were in line with prior guidance, and ultimate expected cash losses also remain in line with prior guidance.

Turning to the balance sheet, we grew both lending and deposits in 2010. Looking at lending, the effect of run-off and muted demand in developed markets was more than offset by growth elsewhere. This was mainly in Commercial and Global Banking, and largely in Asia. Growth was particularly strong in the

second half and was therefore not fully reflected in 2010 revenues. Looking at funding, customer account balances increased by 7%.

I'd also like to spend a few moments on capital. We generated capital through underlying profit growth and saw a high take-up of scrip dividend. The progression in our Core Tier 1 and Tier 1 capital ratios therefore continued during 2010. Meanwhile, as we de-risked the loan book, we saw a decline in risk-weighted assets, even as we grew lending overall.

Finally, we promised to say something about our expectations regarding the new Basel III rules. Certain aspects of the rules remain unclear as to interpretation and application by national regulators, notably any capital requirements which may be imposed on the Group over the implementation period in respect of the countercyclical capital buffer, and any additional regulatory requirement for SIFIs.

However, we believe that, ultimately, the level for the common equity Tier 1 ratio of the Group may lie in a range of 9.5% to 10.5%. This exceeds the minimum requirement for common equity Tier 1 capital, plus the capital conservation buffer.

We have estimated the pro forma common equity Tier 1 ratio of the Group based on our interpretation of the new Basel III rules as they will apply from January 1, 2019 and based on the position of the Group at year-end 2010. The rules will be phased in from 2013, with a gradual impact. But we have estimated that their full application, on a pro forma basis, would result in a common equity Tier 1 ratio which is lower than the Basel II Core Tier 1 ratio by some 250 to 300 basis points. The changes relate to increased capital reductions, new regulatory adjustments and increases in risk-weighted assets.

However, as the changes will progressively take effect over six years leading up to 2019, and as HSBC has a strong record of capital generation and actively manages its risk-weighted assets, we are confident in our ability to mitigate the effect of the new rules before they come into force. By way of example, we generated from operations around 80 basis points of Core Tier 1 in 2010 and around 60 basis points in 2009. That's excluding the effect of the rights issue.

So, with that, thanks for your attention and I'll hand it back to Stuart.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Thanks, Iain. First, let me set out how we're going to measure business performance as a leadership team.

Starting with return on equity, we said last year that we would review the target range once the effect of new regulation became a lot clearer, and we now have better visibility on the impact of higher regulatory capital requirements on returns. Based on our expectations about the effect of the Basel III rules, we've therefore set a new range, and we believe that 12% to 15% ROE is appropriate and realistic for the future.

Now, despite a marked improvement in 2010, we clearly have a lot of work to do. We're not yet where we want to be. And above all, I'm determined that we'll take a very disciplined approach to allocation of capital, and I'll say more about this at our strategy day in May.

Our cost efficiency ratio was also outside our range, which is totally unacceptable. So let me tell you why and what we're doing about it.

First of all, revenues. These were lower, for the reasons Iain has already mentioned. But turning to expenses, these clearly increased. We absolutely cannot position HSBC for growth without incurring investment and development costs. But, as a management team, we're stepping up discipline on cost control. There are structural inefficiencies in parts of our business and we have some reengineering to do.

And I believe that all investments should be self-funding over time. And we're also going to increase our focus at the execution stage, to ensure our investments deliver the full benefits. We will, therefore, aim to deliver a cost efficiency ratio back within range in two to three years.

Now, we've also benchmarked a new prudential advances-to-deposit ratio for the Group. Keeping an A/D ratio below 90% is core to our financial strength and to our philosophy that, as a Group, we should never be reliant on wholesale markets for funding. But to give some context, even at slightly under 80%, which is where we are now, we have capacity for further lending growth.

And finally, we recognize the importance to both institutional shareholders and our loyal base of retail shareholders of reliable dividend income. And I believe it should be possible to benchmark a payout ratio of between 40% to 60% of attributable profits in normal market conditions.

Turning now to the business review, our results continue to prove the value, and in our view the validity, of a universal banking model, diversified both by customer group and by geography. And so, taking the customer groups first, Commercial Banking results were strongly up. Global Banking Markets had its second best year so far, and Personal Financial Services moved back into profit.

So let me start there with Personal Financial Services. We saw a turnaround in PFS, driven by lower loan impairment charges. But as we move away from higher-risk, higher-yield lending, this will inevitably reduce top line revenues further, but at the same time improve the bottom line by reducing loan impairment charges.

Let me tell you where the growth will come from. I believe wealth management is a huge opportunity for HSBC, and this is true both for emerging markets where saving rates are higher and for the aging developed markets with unfunded pension liabilities, such as there are in Europe. Ensuring that we're positioned to capitalize on this opportunity is therefore one of my top priorities.

In 2010, the benefits of our strategy to target higher-quality business were already clear. We grew insurance and investment income in Asia. We won mortgage market share in the UK, where the average loan-to-value ratio was 54% for new lending. And we saw strong mortgage growth in Hong Kong, where we have an estimated LTV ratio of 38% on the overall portfolio. We also grew Premier customer numbers by almost a million. And this business has the right profile for our risk appetite.

Turning next to Commercial Banking, the main point I want to highlight is that we've now rebuilt our loan book post-crisis. Loan balances rose 21% in 2010. Revenues increased by more than twice the rate of global GDP growth. And with lending growth accelerating in the second half, the full benefit has yet to come through on the revenue line.

The drivers of growth are summed up by two themes, global trade and emerging markets. Given our footprint and our connectivity, this positions HSBC in something of a sweet spot. So, despite robust competition and constrained interest margins, we expect further opportunity to grow the balance sheet and to deliver attractive returns.

Turning next to Global Banking and Markets, we had another very strong year, with PBT over $9b. The decline in revenues was more than offset by lower impairment charges. And moreover, much of the revenue decline was in balance sheet management, which we had signaled. Excluding this, total revenues were only 6% lower, driven by, in fact, lower levels of client activity.

We continue to monitor closely our exposure to European sovereign debt, and we've also invested in building out the areas we promised. In 2009, seven business areas each generated over $1b in revenues. We also signaled a year ago that two other businesses have the potential to reach this level in the future. In 2010, asset management reached this level for the first time, as it gained momentum in emerging markets. I still believe that equities will get there as well.

This diversification shows our strategy is working. We've sustained the momentum and kept the revenue levels we gained during the crisis. As a result, I believe the best is still ahead. Our Global Banking and

Markets business has shifted gear and moved to a new level of profitability. You'll recall that our highest reported profit before the crisis was $6.1b in 2007.

And finally, the ratio of total compensation to revenue remained steady at 23.3%, which from a shareholder perspective is one of the best in the industry. This figure is calculated on revenue net of loan impairment charges, on a reported basis, and excludes the payroll tax.

In Private Banking, revenues and profits were broadly stable. However, I believe HSBC has great potential to build out as an onshore private bank in the major wealth-creating markets. We have the global brand and the presence in faster-growing regions, not least a 30-year track record in Asia. Benefiting from this emerging market presence, we saw $13b of net new money in 2010. And this is also net of the limited outflows we saw in response to the Swiss data theft.

Turning next to the regional picture, I'll start first with Hong Kong, the cornerstone of our Asian business. Hong Kong delivered another strong performance, with a decline in loan impairment charges and business volumes continuing their strong recovery.

Now, we're absolutely committed to protecting our market position in Hong Kong. In 2010, we held our number one positions in cards, residential mortgages, deposits and life insurance. We attracted higher revenue from insurance and investment products and higher revenues from trade finance. We built on our market leadership for renminbi products, and we grew lending volumes by over 40%, while maintaining pricing discipline. This will progressively deliver revenue growth over time.

In the rest of Asia Pacific, we increased profits by 21% excluding associates. Meanwhile, the contribution from associates grew by over 40%. And again, we used our capabilities and our connectedness to service growing trade flows, both across the region and increasingly beyond. And we continue to invest in our target markets of India, Indonesia, Singapore, Malaysia, Australia, and of course China.

Next, the Middle East. Clearly, we've been following recent events in the region closely, and at HSBC our primary concerns have been to ensure the safety of our 12,000 staff, and with their support to remain open for business and support our customers. As a strongly capitalized global bank, HSBC's financial performance has not been materially affected by events to date.

In 2010, we also saw the credit situation improving in Dubai, and it's successfully worked through its restructuring. Now, driven by lower loan impairment charges, our profits in the Middle East more than doubled. Clearly, initially, as we de-risked the loan portfolios, revenues fell, but momentum increased as the year progressed, with rising lending and trade volumes.

HSBC has had a presence in the Middle East for over 50 years, and many of the economies in the region have important structural strengths which leave us positive on the longer-term outlook. So we remain absolutely committed to its future.

In Latin America, loan impairments fell and profits recovered by nearly 50%. In Brazil, profits totaled over $1b for the very first time. We also grew lending volumes by 17%, mainly within Commercial and Global Banking.

In Europe, profits declined, as lower profits in Global Banking and Markets more than offset a stronger performance in retail. Global Banking and Markets is obviously a major contributor to our European performance, not least as this is home to two of our biggest dealing rooms. Overall, it remained strongly profitable, notwithstanding lower revenues.

And then, taking the Group as a whole, despite the economic uncertainty, we grew total net lending across Europe by 4%. Specifically in the UK, in Commercial Banking we grew total net lending by 3% to nearly GBP40b, and new lending increased by 17% to GBP9.9b. Within this, we also grew new lending to SMEs by 19% to GBP2.4b, while total net lending to SMEs fell slightly, by 1.6%, as customers paid down debt.

Europe remains absolutely core to our strategy, and we continue to build out the business in the UK, France and Germany. A strong footprint in this region, with an ability to link to emerging markets, lies at the heart of our proposition as a globally connected bank.

Turning next to North America, we returned to profit as loan impairment charges almost halved. Loan balances in the consumer finance run-off portfolios continued to reduce, in line with our expectations. Clearly, this does not leave us with a sustainable business in the US. So, as we work towards a more acceptable level of performance, we'll continue to reposition our core businesses, and I'll talk more about this in May. However, to reinforce the point, the US remains critical to HSBC's strategy as a globally connected bank.

That completes our business review, so let me wrap up with a few comments on the outlook. In the short term, risks to global growth remain, not least from an elevated oil price. We therefore expect cyclical volatility to continue, and progress is unlikely to be linear. In the longer term, we believe that growth rates in many western markets will continue to under-perform those of the emerging world. Emerging markets are no longer simply leading the global recovery from a western crisis. The growth cap has become a sustained secular trend.

I have tremendous confidence that HSBC's global footprint and presence in faster-growing regions will allow us to capitalize on the most important opportunities. We will continue to target growth in the most strategically attractive markets for HSBC, not least the key emerging economies. And we will build our capabilities in connectivity, which absolutely require a strong footprint in North America and Europe.

I also firmly believe that HSBC has the people, the values, the financial strength and the business model to deliver. So it's a privilege for me to have the opportunity to lead HSBC through its next phase of development.

Thank you and back to Douglas.

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

Thanks, Stuart.

Returning briefly to regulatory reform, much progress was achieved during 2010. During 2011, the continuing focus around the regulatory change agenda will be threefold.

First, having reached broad agreement on capital requirements for banks, the focus is shifting to the calibration of liquidity standards. Although liquidity and funding weaknesses were key elements contributing to the crisis, and although our own liquidity position is among the best in the industry, HSBC agrees with the industry consensus that the revised requirements look overly conservative.

It would be nearly impossible for the industry to expand business lending while increasing the amount of deposits deployed in government bonds, and at the same time that many banks, not HSBC, of course, are reducing dependency on Central Bank support. So we hope that the observation period which starts this year will inform a recalibration of these minimum liquidity standards.

A second debate which is of importance to HSBC concerns the designation of systemically important financial institutions, SIFIs. We support the case for heightened supervision of SIFIs, but clearly the imposition of incremental capital for SIFIs would reduce shareholder returns. It would also likely influence, positively from our perspective, counterparty preferences to deal with institutions classified as SIFIs. However, this may therefore have the unintended consequence of further concentrating the industry.

We believe systemic importance should not be determined by size alone. We will therefore continue to make this point, and to emphasize the structural benefits of HSBC's organization through separate subsidiaries, which argue against incremental capital for SIFIs being based on size alone.

Third, and let me make it absolutely clear, we take no issue at all with the right of the UK government to raise a levy on the banking industry, particularly having had to risk taxpayers' money to rescue a number of important UK institutions. However, as the levy is applied to the consolidated balance sheet of the Group, it therefore constitutes an additional cost of basing a growing multinational banking group in the UK. Had the levy been applied to the 2010 year-end balance sheet, we estimate that the annual charge would have amounted to approximately $600m for HSBC, of which the overseas balance sheet would account for approximately two-thirds.

We regard the levy, which is not a tax-deductible item, as akin to a distribution of profits. And for this reason, in the event that the levy is restructured or relieved, we intend to add any amounts saved to future dividends paid to shareholders.

Thank you for your attention today. Stuart is going to chair the question and answer session. And before we begin, the operator will explain the procedure and introduce the first question. Thank you very much.

QUESTIONS & ANSWERS

Operator

Thank you, Mr. Flint. (Operator Instructions).

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Okay. Can I have the first question, please?

Operator

We will now take our first question today from Alastair Ryan of UBS. Your line is open.

Alastair Ryan *- UBS - Analyst*

Thanks. Good morning. I've a number of ultimately related questions, so forgive me if it seems a bit rambling, but I'm trying to stitch a few things together.

First, on the cost growth, I'd love to be able to map some idea of the revenues you hope to get out of that. And in particular, I'm interested that your number of staff grew the most in Europe, and actually you talked quite a bit about GBM as opposed to Retail and Commercial Banking as areas of cost growth, and why that would be.

Second, on capital, your capital is now at the top end of your target range. For the next several years -- and I have in mind the Basel III issues, but those are seven-year issues. You're generating at the bottom of your target range, 100 bps a year, retained. And the 250 to 300 won't work out that way, because you'll mitigate some of it, and actually some of the (inaudible) and other financial deductions won't happen because you'll have higher retained earnings by then. So, why such a small dividend growth? At current rate, it's going to take you about 17 years to get back to peak dividend. And what would you do with the plug, if you end up with capital generation well ahead of what you were talking about?

And I guess third is just to get a sense of your appetite for lending growth. Interesting you mentioned quite a bit of growth in the Private Banking, wealth management and equities and some which are not balance sheet intensive businesses. And to our mind you'd have a balance sheet that was better

positioned to finance growth in the world economy than most other people, and how we should reconcile those. Thank you.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Okay. On the headcount, actually, it's on page 26, the ARA. Actually, the headcount in Europe fell. It didn't go up. Actually, the headcount fell in the developed world by 2,598 and rose in the emerging markets by 8,178. So we added people in emerging markets and reduced them in the developed world, which is kind of what you'd expect us to do.

Some of the cost growth, clearly we expect to deliver revenue. There's a chunk of investment into equity and foreign exchange platforms in Global Banking and Markets. There's investment in Prime Services. There's investment in equity capability --

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

Sorry, Stuart. I'm just looking at the second half. You're up from 73,000 to nearly 76,000 in Europe. Sorry, that was what I was referring to.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Okay. Over the year, it's actually down in Europe and up in the emerging markets. So if you look at year on year, there's no trend that you need to sort of get worried about in terms of a shift in emphasis there.

There's a chunk of the costs that will produce revenue. So there's investments in Global Banking and Markets, which I expect to produce revenue. There's investment in branch network, infrastructure and IT that I expect to produce revenue. There's the rollout of the Advance proposition in Personal Financial Services to 34 countries, which should produce revenue.

However, it would be fair to say that we have a firm that has a certain level of complexity in its cost structure, which is partly a byproduct of being a subsidiarized company where we therefore have multiple head offices, and there also are potentially higher costs stuck within our IT delivery platform than actually we think is the ideal situation. And I'll talk in detail about what we do about this in May.

But the cost efficiency ratio, at 55.2%, is completely unacceptable. We will need to march it back down towards the 52% area. But it would equally be wrong to assume that all the costs are non-productive and won't lead to revenue.

On the dividend, I think it would be fair to say that we still believe there's sufficient uncertainty around as to what the capital requirement for GSIFIs would be. And obviously, the estimate that we've made for what we think the Basel III number that may be applied to us, which is 9.5% to 10.5%, is the capital base that we're assuming that we're going to drive a 12% to 15% ROE off.

Now, that 9.5% to 10.5% may turn out to be too conservative. If it does turn out to be too conservative, then you're correct, we will be generating significant amounts of cash flow. And at that point in time, we would revisit the dividend. I think that we do believe that total shareholder return going forward will be informed as much by dividend as it will by ROE. I don't know if, Iain, you might want to add?

Iain Mackay ***- HSBC Holdings plc - Group Finance Director***

No, not on those points, Stuart. I think we've banded this very clearly around a number of scenarios, and we've laid out where we think these ranges are in the annual report and accounts. There is still significant uncertainty. I think one point of guidance that we do provide is around the range within which we think

dividend payout ratio may fall. Now, that's a fairly broad range. We fall in the high 46s this year through -- by lifting the dividend $0.02, 20% in the last quarter and 6% overall.

But the key issue here I think is uncertainty as to how capital plays out over the course of the next 18, 24, 36 months. But clearly our propensity to revisit and continue to grow the dividend is absolutely at the front of mind.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

And we're not working on a 17-year timescale for this, Alastair.

Alastair Ryan *- UBS - Analyst*

Thank you.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Can we get the next question, please?

Operator

We take our next question today from Sunil Garg from JP Morgan. Your line is now open.

Sunil Garg *- JP Morgan - Analyst*

Hi, Stuart. Good morning to you. I have two questions on Commercial Banking, CMB. The provisions went up quite significantly, second half over first half. So if you could give us some color on that, that's question number one.

And just picking up on the return on equity target, the 12% to 15%, if I look at your numbers in the second half of 2010, and assuming that you are able to deliver your cost improvements over the next two, three years, assuming that credit improvements perhaps continue to normalize, also looking at your guidance on the net interest income increase from interest rate increases, I would think that the low end of your target range either appears conservative or you're making a call on dividends or capitalization. Could we have some color on that?

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Sorry, what was your point about the lower end? It's conservative?

Sunil Garg *- JP Morgan - Analyst*

No. If you look at -- assuming interest rates to be higher, credit charges to be lower and cost efficiency targets to be met, that 12% return on equity target seems to suggest substantially more than the 9.5% to 10.5% common equity Tier 1 which you're guiding. So, just wanted to get some understanding behind the low end of that target range.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Absolutely. Look, what we've done is we've worked the 12% assuming that interest rates don't go back up. So we're assuming that we should be able to get to the 12% basically out of shifting the shape of the balance sheet from the US with very high-intensity RWA, loss-making assets in HBIO, to much lower RWA, positive ROE assets in the emerging markets, and some cost restructuring. What we're not assuming to hit the 12% is that the interest rates normalize.

So it is conservative. And as I say, we're assuming we can march our way to the 12%. Now, bear in mind we're at 9.4%, so it's quite a big journey from where we are, but that we can get to the 12% without having a normalized interest rate structure. So it is conservative to that extent.

CMB is a specific charge with actually a client in Singapore. So it's not a series of losses, and therefore it's not a trend that you should be concerned about. It's a kind of idiosyncratic risk.

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

Stuart, just to clarify that 12% calculation, is there a credit improvement from second-half 2010 level, or is that also assumed to be steady at that level?

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Well, we're assuming in getting the 9.5%, 10.5% that the CVAs in the capital calculation are the conservative ones that currently are on the table.

Iain Mackay ***- HSBC Holdings plc - Group Finance Director***

I think on this particular point, in terms of overall loan impairment charge improvement, we've taken where we sit in the second half of 2010 as a starting point, and on that particular line we've not built in huge degrees of improvement. So, to Stuart's point, across most lines in the income statement and balance sheet we've taken a reasonably conservative approach to modeling out the ranges that we've got here, Sunil.

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

Understood. That's great. Thank you.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Thanks, Sunil. Next question, please.

Operator

Our next question today comes from Ian Smillie from RBS. Your line is open.

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

Good morning. Two lines of questions. The first one is on the uplift in general admin costs between the first half and the second half. Looks like it's up something like $1b, from $4.9b to $5.9b. If you could just color in for us a little bit what's happening there, that would be very helpful.

And secondly, on the guidance on the BISIII and the core Tier 1 ratio, it looked, from our calculations, something like $100b more RWA uplift than we might have estimated. And I'm wondering whether specifically you could color in for us what assumption you're making on the impact from unconsolidated investments, which you mention in the words but which, as far as we can see, don't give any numbers against that. And in particular I'm thinking about whether that's related to Bank of Communications or whether it's related to Ping An or whether it's related to some other unconsolidated investment we can't see. Thanks.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

I think, Iain, you should probably take both of those.

Iain Mackay ***- HSBC Holdings plc - Group Finance Director***

Yes. Look, if we go to the admin costs, I think there's two or three elements here. Stuart referenced already some of the inbuilt structure that we believe we've got to do from an IT perspective, and this is the area in which a lot of our IT cost is carried. So there is some work that we need to do there, in terms of understanding run rates and a bit of restructuring in that particular space.

Some of the significant factors in the second half of the year was an increase in regulatory costs and litigation costs, most notably within Europe and within the US. So those are the three main areas that are uptick in the second half of the year, and particularly in that one area, Ian. And obviously, from a reg cost perspective and litigation, they are obviously under our control, but they're not necessarily linear in terms of how they flow through the income statement. As it relates to the technology platform, there's obviously a good deal of that that we can do and are focused on bringing back in line.

When you look at the Basel III question, I think if you could just repeat the last point that you had in that question, Ian.

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

I'm really looking for some color on your assumptions on the impact from unconsolidated investments, which we wonder if that's the missing piece because --

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Iain Mackay ***- HSBC Holdings plc - Group Finance Director***

No. No, I think, Ian, overall, the range that we've given here is a fairly broad range, because there is still uncertainty in a number of areas. If you look at counterparty valuation adjustments, for example, that is still an area where there's significant interpretation both at a European -- well, at a Basel III level as well as an FSA level, so that's a broad range. Areas which are reasonably well nailed down are market risk under, if you like, Basel 2.5 and the trading book; that's fairly clear. I think another aspect that is still coming through are some of the deductions from capital.

But I think one of the things that we've not factored into that 250 and 300 basis point movement is an assumption around any management actions, which again is a somewhat conservative hair-shirted approach, perhaps what you would expect from us, recognizing that over the course of the last two years we've been able to take some fairly clear actions around mitigating risk weightings. And you saw that in the movement of risk-weighted assets overall for the Group in 2009 to 2010.

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

Understood. Is there any chance, Iain, you could put some broad numbers against each of those buckets that you've articulated? You are talking about some fairly large numbers here, and it would be very helpful to try and pin down where each of the impacts are coming from.

Iain Mackay *- HSBC Holdings plc - Group Finance Director*

Very broadly, if you think about the range that we've talked about being two-thirds increase and risk-weighted assets, and a third being deductions against capital, that's probably a way to think about it, Ian.

Ian Smillie *- RBS - Analyst*

And within the RWA, I was looking for a step further in terms of the counterparty credit risk, the market risk, the unconsolidated investments. We are talking about $200b or $300b here, so there are some quite big numbers to try and pin down.

Iain Mackay *- HSBC Holdings plc - Group Finance Director*

Yes, I am sure you were. We can maybe talk about it separately.

Ian Smillie *- RBS - Analyst*

Thank you. And on the cost comment that you made, should we think about the marching down, as Stuart put it, back to the cost/income ratio target to be fairly linear from here, or is there some suggestion that there could be some restructuring costs required in order to get you to that lower new world cost/income ratio?

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

We've started the work, Ian, and it's possible that we may take a restructuring charge. But at this moment in time, we haven't done enough analysis to know whether that's necessary.

Ian Smillie *- RBS - Analyst*

Okay. Thanks, Stuart.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Thank you. Next question, please.

Operator

Our next question today comes from Rohith Chandra-Rajan from Barclays. Your line is now open.

Rohith Chandra-Rajan *- Barclays Capital - Analyst*

Morning. It's Rohith Chandra-Rajan from Barclays Capital. Could I just follow up on the Basel III question, actually? Just kind of thinking maybe about 2013, if I take the 10.5% Basel II core Tier 1 ratio now, assume a 80 to 100 basis points year-on-year capital generation, gets me to maybe 13%, 13.5%, so

taking off your Basel III number 10% to 11% kind of range. Just wondering, in terms of the 2.5% to 3% Basel III impact, how much of that might drop away in terms of things like DTAs, etc., by 2013.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Iain?

Iain Mackay *- HSBC Holdings plc - Group Finance Director*

I think, again, this -- Rohith, this falls back into the range of management actions which, as Douglas pointed out, we've not reflected overall in the numbers we've put in. The deferred tax assets that we carry on this balance sheet relate to timing differences on accumulated losses in the United States, as well as a couple of businesses in Latin America. And I think the reversal of those is we're somewhat encouraged by the improvement in performance in the North American business this year. And this falls into the range of things that to some degree are within our control from a management action's perspective.

So I think, overall, we haven't factored in management actions. But being able to manage deferred tax asset decisions depends on generating the profitability, certainly within North America, which is a significant piece of the work that Stuart referred to earlier, that we need to focus on rebuilding our core businesses there.

Rohith Chandra-Rajan *- Barclays Capital - Analyst*

And you were able to quantify the DTA contribution, for example, to the 2.5% to 3%?

Iain Mackay *- HSBC Holdings plc - Group Finance Director*

Yes, we are.

Rohith Chandra-Rajan *- Barclays Capital - Analyst*

Would you like to share it?

Iain Mackay *- HSBC Holdings plc - Group Finance Director*

No.

Rohith Chandra-Rajan *- Barclays Capital - Analyst*

Okay.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

These Scottish Finance Directors are incredibly tough.

Rohith Chandra-Rajan *- Barclays Capital - Analyst*

Can I ask a separate unrelated question, actually, just on impairment charges? So, just looking specifically at Europe, Hong Kong and Asia Pacific, so the charge in the year was 86, 16 and 89 basis points, respectively, just wondering on your thoughts of normalized levels for those three geographies.

Iain Mackay ***- HSBC Holdings plc - Group Finance Director***

Sorry, come again with that question?

Rohith Chandra-Rajan ***- Barclays Capital - Analyst***

Just wondering what your view of normalized -- the normalized basis point impairment charges for Europe, Hong Kong and Asia Pacific.

Iain Mackay ***- HSBC Holdings plc - Group Finance Director***

We've probably -- this year in Asia Pacific has been incredibly benign. We've actually -- in the commercial book, we've seen write-backs, which is extremely unusual. But I think overall, if you look at the PFS business and Global Banking business in Asia Pacific, Middle East outside Dubai, Latin America, probably close to normalized levels, probably close to normalized levels. Obviously, in North America there's still a good deal of work to do within the Consumer Finance portfolios, but if you looked at Commercial Banking, the rest of PFS, the Commercial Banking, Global Banking, probably at reasonable levels compared to the norm, I would say.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Yes, I would agree with that. Okay. Can we take the next question? Thank you.

Operator

Our next question today comes from Arturo de Frias from Evolution. Your line is now open.

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

Hi. Good morning. Two questions quickly, if I may, please. First one, again, I am sorry, on risk-weighted assets. Would it be possible for me to suggest that it would be extremely useful if we have much more detail on the RWA increases that you are looking or including in your guidance? Because, as a couple of my colleagues mentioned just now, we are talking about very large numbers here, and I think we are all a bit surprised with the guidance. I think we were -- or the consensus was going for more in the region of 150 bps of impact. So the more detail we can have here the better, please.

Along these lines, is -- given that for sure your unconsolidated investments will be one of the main impacts, are you thinking again -- or are you kind of reviewing what is the structure of those investments, whether you could -- you have said you are not including anything from management actions. Could one of these management actions be restructuring in some way some of your stakes, some of your investments, so that they are less capital intensive?

And then the other question would be it's not very clear to me what kind of impairment level you are building in your guidance, in your ROE guidance. We just heard from Mr. Gulliver that the 12% does not include any rate increase, but what's the level of impairments that you are including in this 12% to 15% ROE? Thank you.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Okay. I'll ask Iain to deal with the loan impairment charge. On the first two, the fact that we obviously need to give more RWA detail, suggest what we do is we tackle this, and actually this was our plan anyway, in detail on the investor day, so that we can give you a deep dive on where we're coming up with the numbers we're coming up from. And also, therefore, any decisions we make on any disposals of anything is a subset of an investor day, as opposed to a comment I'd want to make in the context of the 2010 results.

The assumption of loan impairment charge numbers in that ROE, Iain?

Iain Mackay *- HSBC Holdings plc - Group Finance Director*

Yes, absolutely. We mentioned this a little bit earlier. We really took where we saw run rate from the second half of the year and factored that into the overall modeling for, if you like, the P&L and the balance sheet in terms of where we see the 250 to 300 basis point impact coming in, and overall return on equity target. So there's still probably a bit of improvement that needs to -- well, there's a significant improvement that needs to come through the North American book.

But given where the residential property market is in the US and where unemployment is in the US, it's very difficult at this stage to see the rate of improvement coming through those books of business. Recent actions with respect to foreclosures probably actually make this, across the system, an even slower recovery than probably any of us had anticipated. So, there's probably some degree of elevation in the North American space there, in terms of the speed of run-off of that portfolio and the loss experienced throughout that run-off, but otherwise I think what you saw in terms of the second half is a reasonable range of estimates from a loan impairment perspective.

Arturo de Frias *- Evolution - Analyst*

Okay. Thank you.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Thank you. Next question, please.

Operator

Our next question today comes from Ronit Ghose from Citigroup. Your line is now open.

Ronit Ghose *- Citigroup - Analyst*

Great. This is -- it's Ronit from Citigroup. I just wanted to follow up on the KPIs. I know we'll get a lot more information on the investor day, but specifically on the cost/income ratio, you said the ROE, the 12%, 15%, 12% on basically current rates, etc., on the KPI on the cost/income ratio, when do we get towards the high end of that range, the 52%? We're at 55% last year. Stuart, you said several times the 55% is unacceptable. But is 52% an achievable number for '11 or '12, or just further out in the medium term?

Also, on costs, the $3b increase last year in costs, you split out the clear one-offs. How much of the additional cost increase would you say would be business as usual cost and how much of it is your upgrading platforms like you've referred to, in e-platforms, etc.?

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

I indicated that I think that getting to the 52% is kind of two years, so end of '12, '13. I don't think we can do it in 2011. As you'll see, we've added $3b to $4b of costs in the last two years.

As for how much is business as usual, the number that sits under Europe, there's a block under Europe on the slide; that is primarily investment in Global Banking and Markets. So Prime Services, the equity market platform, the expansion of rates and FX e-commerce platforms, and I expect to get returns on that. We've also invested in rolling out Advance, which if you like is the feeder product into Premier. That's now in 34 countries. That again is a business as usual cost that I expect to see revenue on.

So, excluding one-off items, the costs are up 6%. Within that, I would say probably half of that is actually revenue that will -- is revenue-enhancing investment. And the other half of it is stuff where the payback is obviously too far in the future for our own comfort, would be probably the best way of describing it. None of it is clearly costs we didn't need to spend. It may have been stuff that with the benefit of hindsight we could have done more efficiently, or with a shorter payback time horizon. And it's that bit that we've got to look into.

Some of this cost efficiency or inefficiency lies in having multiple head offices and lies in the way we've gone about managing our IT process. And this will take a while to restructure. This isn't a kind of 2011 quick fix. And what we'll need -- and we'll talk about this at the investor day, but we clearly need to find sustainable savings. HSBC is really good at cutting costs, but what it tends to do is cut discretionary expenditure, so cut marketing, cut travel, cut recruitment. As all of us know, within a year or so they're back, because actually they're not sustainable saves. So when we talk about reengineering, that's what we mean. If we've got five data centers, can we do with three and run them 24 by 7. That requires a bit more time than 2011.

Ronit Ghose *- Citigroup - Analyst*

Great. Thanks. Can I just have a quick follow-up, on Hong Kong, on the loan growth? I don't know if you've mentioned this already, but what percentage of the disbursements, either abroad in Hong Kong or specifically in CMB, comes from businesses that are operating outside Hong Kong? I think HKMA data shows about one-third of the new lending in Hong Kong last year was for businesses outside Hong Kong, and I'm just wondering how you view the credit quality of this kind of lending.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Well, the credit quality we're comfortable with. The team that have been putting the lending in place are acutely aware of the volatility of the Asian markets, and effectively have been with us through the Asian crisis of '97, '98. Most of the lending we'll be doing in Hong Kong relates to Hong Kong or to mainland China. It wouldn't be Malaysian lending. That would be booked in Malaysia. So credit quality we're comfortable with. We've got a very experienced credit risk officer in RM there, and we're comfortable with the lending that we're doing.

Ronit Ghose *- Citigroup - Analyst*

Thank you.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Next question, please.

Operator

Our next question today comes from Simon Samuels from Barclays. Your line is open.

Simon Samuels *- Barclays - Analyst*

Yes. Good morning. It's Simon Samuels here from Barclays Capital. Sorry, I just wanted to go back to the ROE target, and actually to just really understand what you're communicating to us today, because it's moved down quite substantially from six months ago, and to be fair you said then that it was subject to some Basel III clarification. It looks like it's moved down by a bit more than just a Basel III higher capital ratio requirement.

So my question is, is that new ROE target of 12% to 15% reported, which I guess is 2 or 3 percentage points higher on a tangible basis, is that the product of a big review internally, not just of the extra capital but also of the cost base and revenue prospects and normalized provision? Or is that literally the mechanical effect of higher capital ratios and these other components, cost revenues, the through-the-cycle provision impacts, that those are still to be incorporated and we may hear more in the investor day later on this year around those things?

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

It's more the former than the latter. When the 15 to 19 was designed, Tier 1 was 8%, short-term interest rates were 5%. We're not sure where Tier 1 will end up, but we're being conservative in the estimate we make today. Short-term interest rates, clearly we have, as you know, an AD ratio sub-80. Short-term interest rates have removed one of the significant engines of revenue growth for this firm, which is its deposit spread. And we're working on the assumption that that will take some years before it comes back.

We're running down household. We're going to shift the mix of businesses across to Asia Pacific. So the 12% to 15% is kind of an output of all of those things, which are still going on, which is why the investor day is set for May. But it's not just a mechanical adjustment for what we think is a conservative view on Basel III. The Basel III view is conservative. To reiterate, we've assumed no management action. As you can see in the 2010 numbers, we actually grew lending and dropped the risk-weighted assets, so it is conservative.

But we're still at the moment, Simon, at 9.4%, with a cost of capital of 11%, so to get from 9.4% to 12% is a 33% increase. So it may seem conservative, but it would be quite useful if we actually got inside one of the target ranges that we've set.

Simon Samuels *- Barclays - Analyst*

Well, you are on the asset/deposit ratio, I guess.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Yes. Thank you.

Simon Samuels *- Barclays - Analyst*

Thanks.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

We're actually okay on the dividend distribution as well. It's a journey, is the best way to put it, but it's one that we absolutely are going to need to execute on.

Simon Samuels ***- Barclays - Analyst***

Thank you.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Next question, please.

Operator

Our next question today comes from Leigh Goodwin of Citigroup. Your line is open.

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

Good morning. A couple of questions on revenues, please, firstly in GBM and secondly in the HSBC Finance Corporation. Just in GBM, obviously we've seen some decreases, half on half, and I wondered if you could just give us an indication of where you see those maybe normalizing, in particular maybe how we've started 2011 in areas like rates and credit.

And also, in terms of balance sheet management, clearly still heading down, is there any guidance you can give us to where you expect that to trough out?

And then, turning to the household, the old household business, so the Finance Corporation, it looks like a good performance in the fourth quarter, I have to say. It looks like you turned in a profit, with quite a jump in revenues. I wonder if you could just talk about that. Is that the end of the de-leveraging in the credit card and private label books, and now we can look forward to revenue growth, perhaps, from those areas? Thank you.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

I'll take Global Banking and Markets, then Iain can talk on household. You're right, the second half saw weaker revenues from balance sheet management, rates, credit, slightly weaker in foreign exchange. There was quite a pronounced drop off in activity in the second half, particularly around the European sovereign space and debt capital market issuance, and therefore activity around that space. I don't think that necessarily is a trend that we need to be particularly concerned about. We started, actually, the year well in rates, in credit and in foreign exchange. So, basically, the first two months have actually been good.

Balance sheet management, the second half was obviously substantially lower than the first. I think that an equilibrium full year for balance sheet management is around the $2.5b number. Now, bear in mind, back in 2004 I think it got as low as $700m, so I think that this time round equilibrium around $2.5b.

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

Okay.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Now, clearly, Leigh, shape of yield curve, what happens in the meantime could all change that. Hopefully, if the shape of the yield curve remains positive, change it to the up, but $2.5b as an equilibrium.

Iain Mackay ***- HSBC Holdings plc - Group Finance Director***

Okay. On household, I'd be deeply disappointed if we got through this without being able to emulate Douglas and actually quote a page reference from the annual report and accounts. So, on page 72, there is a breakdown of North American profitability.

On HFC, we actually did not turn a profit in 2010. So if you give a little bit of breakdown around that, the run-off portfolios in the mortgage services, consumer lending, that's running off very much as expected and contributed a significant reduction in loan impairment charges. The credit card portfolio actually had a great rebound in 2010. The loan impairment charges more than halved. This business actually remained profitable through the entire cycle. The return on equity in that business bounced back nicely.

So, within the old household portfolio in approximative terms, credit card's performing well. The run-off portfolios in mortgage services and consumer lending still losing money, and that, to be perfectly honest, likely to be the case for a couple more years as we run this through. The US bank had a good bounce back in 2010, grew lending in Global Banking and Commercial Banking. Loan impairment charges again came down in that space, particularly in the available for sale area within the Global Banking space.

Other things that make up North America, you've got Canada, which had a nice rebound with lower loan impairment charges, but also grew lending in Commercial Banking and Global Banking with good revenue pickup, and then Bermuda being the last feature of North American profitability.

So the run-off overall in household is going very much as expected, but this one needs a lot of attention for the foreseeable future. The residential property market in North American is still, I think, deeply distressed, and likely to be so for some time. So keeping a close eye on employment levels and residential property prices, and continuing to work on reshaping the core banking operations in the US.

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

Yes. Thanks. Actually, I was thinking just in terms of the fourth quarter. It looks as if -- maybe you could confirm that the -- under the IFRS basis or management basis, the old household -- the Finance Corporation looks like it made a small profit, with the increase in revenues in 4Q over 3Q. And I was just -- my question was really whether there was anything peculiar about that, or whether that just reflects the growth in the private label book and wider margins or whatever it might be.

Iain Mackay ***- HSBC Holdings plc - Group Finance Director***

Right. There's one particular feature within the fourth quarter in particular, which is the movement in rates and the effect it had on our non-qualifying hedges. So we got a pickup on our non-qualifying hedges in the fourth quarter that flowed through. And there are two areas where we've got NQHs in place. It's the HSBC Holdings fixed rate debt that's issued here, so we've got principally interest rate and cross-currency swaps hedging that. And then in the US we've got interest rate and cross-currency swaps hedging the extended duration on the run-off of the mortgage services and consumer lending.

So it's the pickup in the NQHs that kicked in, in Q4, that gives us that appearance of profitability. It's much appreciated, of course, but the nature of the NQH is that it's economics and volatility in the movement of rates as opposed to, if you like, sustained profitability.

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

Okay. Thank you.

Iain Mackay ***- HSBC Holdings plc - Group Finance Director***

Thanks. Next question, please.

Operator

Our next question today comes from Robert Law of Nomura. Your line is now open.

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

Hello. Good morning, everybody.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Hello, Robert.

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

There's three areas I'd like to explore, please. Firstly, on the balance sheet management revenues, is that $2.5b indication for 2011? And have you increased the duration of your holdings within the balance sheet management activity, because obviously the $4b you reported was considerably above the guidance given even in the second half of last year?

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

It is in respect of 2011. We have to some extent re-lent the book, but we have not -- we are not at capacity, as it were. So there is some element where steeper curves we have reinvested. So it's a 2011 conservative equilibrium number.

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

And have you gone out on the duration beyond the three years that you --?

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

No. We never will in balance sheet management. The whole kind of principals and rules of it is this is kind of the liquidity. So it tends to be kept very short. So even if the curve gets incredibly steep at the 10-year, that won't come through the BSM number. It may come through the rates P&L, because it would be taken up by guys in mark-to-market books trading government bond markets, but it wouldn't come through BSM. BSM is three and under, and will stay three and under. It's kind of the policy rules we have on it, which I don't see any reason to change. But steeper curves undoubtedly help.

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

On the second point, you've given some indication here on the cost line that there is some areas of specific cost action. Could you quantify the kind of cost savings you would be targeting as part of this? So you've give this indication getting it down from 55% to within the target range over two to three years, but you said some of that's revenue and improvements in the operating efficiency, some of it is specific action which you are obviously taking. Can you give us -- what I'm interested in is how much the actual cost measures are designed to achieve of that.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Yes. We'll provide detail in May on that, Robert.

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

Okay.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

The higher point of this has got to come from cost, not from revenue, in my view. The revenue would be a nice thing to have, but the focus has to be with my team on getting the costs reengineered rather than assuming we're going to get a revenue lift and that's how we solve the CIR.

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

And the final area was on the ROE target. I think the -- going from 9.5% to 12% on the existing capital base would require a net income of $16.5b, something like that, and I could see how you'd get there from the run-off of the household portfolios. But if you imply a 200 basis point type strengthening on your capital base, you're going to need another 20% on the net income on that to get you to something like $20b, if it's on that basis. And I'm interested as to how you feel you can get to that.

Iain Mackay ***- HSBC Holdings plc - Group Finance Director***

If you look at what we've laid out, Robert, the timeline over which we have to implement Basel III, as you well appreciate, is an extended one. And if you take a look at what we've done in terms of capital generation in 2009, ex-rights, it was 60 to 70 basis points. If you look at what we've done in terms of capital generation this year, it's about 90 basis points. So if you factor that in over the number of years and tie back into what I'm sure you've got build into your model in terms of retained earnings, it gives you some indication of what we've got to do.

And that leads into continued conservatism around what we do on dividends. There needs to be some certainty about what the capital requirements are. And until we get to that point, it's going to be a little bit more difficult in terms of really nailing down guidance in this regard. Your model probably makes some sense, but the extended timeline here and the absence of management actions, which we clearly can and have in the past taken, is what influences our thinking here.

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

Yes. What I'm looking at is what management sees as an achievable level of PBT. And from your answer here, I'm going to assume it's currently where the stated equity is as opposed to any increase in that required by Basel III.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Yes.

Robert Law *- Nomura - Analyst*

Fine. Thank you.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Next question, please.

Operator

Our next question today comes from Ian Gordon of Exane BNP Paribas. Your line is open.

Ian Gordon *- Exane BNP Paribas - Analyst*

Yes. Good morning. It's Ian Gordon from Exane BNP Paribas here. Just two questions, both around the margin issue. You provided us with the usual helpful guidance in terms of impact of a parallel shift in the yield curve. Other banks have chosen to draw our attention to potential changes caused by management action. So my question is, is the yield curve shift disclosure your best guidance for the NII impact, or is there additional color you'd like to add on that?

And the second part is, in terms of the ongoing asset spread pressure you're seeing in Hong Kong and rest of Asia, unsurprisingly your comments referenced ongoing pricing pressure on HIBOR mortgages and across the piece pressure in that geography. Is your base case expectation just a continuation of those trends, or is there any additional color you could share?

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

Okay. On the interest rate sensitivity piece in the annual report and accounts, if -- I can't remember the page, but I'm sure Iain and Douglas know it encyclopedically, but it's -- sorry, what is it?

Iain Mackay *- HSBC Holdings plc - Group Finance Director*

150.

Stuart Gulliver *- HSBC Holdings plc - Group Chief Executive*

150. It's basically modeled on 25 basis points per quarter, and you end up with $800m extra of NII. It basically assumes a passive approach. And what you essentially end up with is considerably greater NII in Commercial Banking and PFS and some losses in balance sheet management, which get you to an $800m plus number, if you get four lots of 25 at quarter ends, which is what's assumed within that. So it doesn't assume any management action.

On the asset spread pressure, I think that will continue. I don't think there is a magic solution to that at all.

Ian Gordon *- Exane BNP Paribas - Analyst*

Fine. Thanks very much.

Stuart Gulliver - ***HSBC Holdings plc - Group Chief Executive***

Next question, please.

Operator

Our next question comes from Mike Trippitt from Oriel Securities. Your line is open.

Mike Trippitt - ***Oriel Securities - Analyst***

Good morning. I've got two questions. The first is just on your -- the confidence level around capital generation in the near term. I understand what you're saying about 2009 and '10, but you've had two years of consecutive risk asset reduction and obviously a substantial profit rebound last year, to give you that 80 basis points kicker to Core Tier 1. But going forward, I would have thought risk assets would start to pick up again in the very near term. And if you're paying out, say, half of your ROE, then I would have thought there's not a lot left to rebuild capital going forward. I just wondered if you could comment on that.

In conjunction to that, unless I've missed it in all the disclosure, the usual geographic disclosure on risk assets isn't there in the capital section. So I just wondered if you could just talk about what's happened with North America risk assets overall.

Stuart Gulliver - ***HSBC Holdings plc - Group Chief Executive***

Okay. Let me kick off and then Iain can pick up on risk-weighted assets and add some color. Don't forget there are substantial run-off books, Mike. You've got the SIVs and conduits in rundown, so the whole structured credit piece that sits in Global Banking and Markets that effectively is generating no ROE but consuming equity and risk as a result of being a substantial risk-weighted asset, plus the rundown of the household books. So there's still a substantial run-off that's actually still to come in terms of capital, effectively, that's almost stranded and producing no ROE against it.

Iain?

Iain Mackay - ***HSBC Holdings plc - Group Finance Director***

Now, if -- Mike, the breakdown that you're looking for is on page 50, which gives you both the assets by geography as well as the risk-weighted assets by geography. And what you've seen in North America is a run-off in risk-weighted assets, and so I think it ties very closely with what Stuart's represented in terms of the shift of the asset book here. Clearly there's a focus on running off those portfolios in North America. There's an opportunity to reallocate that to North American business, and as we're able to release capital from North America, move that globally as well.

I think timelines around those are difficult, for all the reasons that we've discussed earlier. But I think the actions that we have taken and can continue to take in this regard are fairly clear.

Stuart Gulliver - ***HSBC Holdings plc - Group Chief Executive***

We've got time for two more questions, so penultimate one, please.

Operator

Our next question today comes from Michael Helsby from Bank of America. Your line is open.

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

Yes. Morning, everyone. I've just got a few questions. Firstly, the dividend payout ratio was 50% this year. As earnings recover, should we think about you pretty much staying in the middle of that range? Would you encourage us to think about that?

Also, on the cost line, there's been a lot of focus today on costs. I think in the answers you mentioned regulation and litigation costs. I was wondering if any of those were one-offs, and if so if you could quantify them, please.

And also, just finally, on loan growth, there's quite an acceleration in loan growth in Asia, in Hong Kong and in Asia, in the second half of the year, and clearly that was -- fed through quite nicely into NII growth. How should we think about loan growth in Asia for you in 2011? Has there been a step change and therefore we should think about it easing, or is there just a big risk appetite drive there?

And also, in the UK, I noticed your points you've made on loan growth. Does that mean we can expect positive revenue momentum coming through in the UK, and if you could -- Thank you.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Okay. Loan growth in Asia Pacific, we intend to keep the momentum going. Basically, in 2007/'08, we really took the foot off the gas in Asia Pacific. We need to, and have been, basically rebuilding our position and we'll continue to do so. We believe the risks are reasonable and we believe that we know what we're doing in terms of lending there. So the momentum will continue, and therefore I expect to see revenue coming through. We absolutely are open for business in the UK, and we will continue to lend in the UK.

On the dividend, the range is there because we would expect to use the range. So it's difficult to say you should always assume we'll be at 50%. It kind of depends on the regulatory environment, and frankly how much PBT we've got. So I wouldn't want to turn the range into a specific number. The range is there for a reason.

On the cost line one-off regulation, litigation, there are some one-off costs in there. Iain?

Iain Mackay ***- HSBC Holdings plc - Group Finance Director***

Yes. I think if you want to get a little bit more flavor and detail on what's going on in the litigation front, the principal elements of this are covered in disclosures in note 44, Michael. In terms of individual provisions against litigations, we haven't provided disclosures in that regard at this point.

I think the underlying issue here is that it's not so much litigation. In actual fact, if you look at proportionality around cost increases in this regard, it's as much to do with building the capability around changing regulation as it's got to do with litigation costs at this stage.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Okay. Time for our last question.

Operator

Our last question today will come from Alastair Ryan of UBS. Your line is open.

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

Thanks. More briefly this time. So the second-half cost/income at 58% and 53% in the first half; was there -- were you disappointed with the revenues that came through in the period, or was that a planned rate of growth?

And clearly feeding through from that, you're considerably distant from your target range at this point. How quickly can you move back towards it? I take your point that you're only (multiple speakers) this year.

Stuart Gulliver ***- HSBC Holdings plc - Group Chief Executive***

Okay. Clearly, second-half costs are always higher than first-half costs. So you've got increase in the variable pay, wage inflation, increased headcount in emerging markets as we've hired people, marketing costs to run out Advance, run out Premier, the strategic investment in the platforms in Global Banking and Markets, litigation, compliance costs. All of those kind of sit in the second half. And though the revenue didn't come through, the BSM line was -- clearly fell away. Credit and rates clearly fell away. And we had some specific loan impairment charges, like the CMB charge in Singapore that we talked about. And you're right; the run rate of 58% is the reason why getting us to 52% isn't a 2011 item.

Okay. Thank you all very much. In closing, I just want to recap the key headlines.

So our financial performance in 2010 was strongly improved on 2009 and well balanced across the Group. All the customer groups and regions were profitable, including North America. We've continued to generate capital, and this has enabled us to increase the dividend. And we have had a good start to 2011, with continued momentum in lending, mainly in emerging markets and in respect of trade.

So we're going to be in touch with you guys soon about our strategy day in May, but in the meantime thank you all very much for your time today and for your interest in HSBC. Thank you.

FORWARD-LOOKING STATEMENTS

This presentation and subsequent discussion may contain certain forward-looking statements with respect to the financial condition, results of operations and business of the Group. These forward-looking statements represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Additional detailed information concerning important factors that could cause actual results to differ materially is available in our Interim Report. Past performance cannot be relied on as a guide to future performance.