2011 Interim Management Statement

Investor and Analyst Conference Call

Presentation
9 NOV 2011

Operator

Good afternoon, ladies and gentlemen, and welcome to the HSBC Holdings Plc interim management statement, HSBC Finance Corporation, and HSBC USA Incorporated third quarter 2011 results conference call with investors and analysts.

For information, this call is being recorded, and at this time, I would like to turn the call over to your host today, Mr. Stuart Gulliver, Group Chief Executive.

Stuart Gulliver, Group Chief Executive

Thanks very much. So welcome, everybody, to this call. I have Iain Mackay with me here today. We're both in Hong Kong. So we'll give you a quick overview of the results, and then obviously go to questions.

As you've seen, our reported profit before tax for the third quarter was $7.2 billion, which gives us a year to date of $18.6 billion, both of which of course include around $4 billion of movements in the credit spread on the fair value of our own debt; so clearly therefore meaningless. Therefore, if we switch the underlying numbers, which is clearly how we all judge the Bank, it gives us a bit of a clearer picture of what's gone on.

The underlying profit before tax for the third quarter is $3 billion, which is down $1.6 billion on the same period in 2010. And the underlying PBT for the year to date was $14.4 billion, which is down $300 million on 2010.

Now as you all know, because we all work in the same industry, the industry has faced significant headwinds during the third quarter, not least the Eurozone, which has impacted our performance. In fact, there are three main factors which have impacted our underlying profit before tax in the third quarter.

First, the Eurozone uncertainty which hit revenues in Global Banking and Markets through the rates and credit line. Secondly, adverse movements in non-qualifying hedges, reflecting a decrease in long-term US interest rates, impacted our US run-off book and our UK holding company. Our loan impairment charges also increased, mainly in the run-off portfolio in North America, although, on a year-to-date basis, loan impairment charges are still lower than 2010.

Now these three factors were also partially offset by increased revenues in most markets in Commercial Banking which, if you recall, is a business where we have been investing. Now notwithstanding the difficult conditions in Europe, in the year to date, a number of our global banking markets businesses have made good progress. Actually, revenue in six out of the eight business lines in Global Banking and Markets, which you can see in detail I think on page 23, or thereabouts, of the IMS statement, are actually substantially up. So 17% increase in foreign exchange, within which Hong Kong is up 30%, the rest of Asia Pacific is up 40%, Latin America is up 50%, and North America is up over 35%.

Our Equity business is actually up 45% year on year, and Payments and Cash Management is up 35%, with particularly strong results in the rest of Asia Pacific.

The important thing is these are the areas we've been investing in, and if you recall, this was partly why we had expense increases in Global Banking and Markets in previous quarters and negative jaws. So it's pleasing to see that we're starting to see some returns on the investments we've made in that business.

Now obviously, we've increased focus on strategy during this period. We've substantially upped the pace of change, and we've made real progress in implementing what we outlined to you back in May. And I think it's important that I update you on these now.

First, under the five filters heading, we've announced 14 transactions year to date, 11 since June 30, including the disposal of our US Cards business, and 195 branches in upstate New York. These transactions, all 14, could release over $40 billion of risk-weighted assets, and affect 14,000 employees, of which actually more than 13,000 will transfer to the new acquirers. We will re-deploy the capital, when it's released, to fast-growing markets.

Second expenses. Actually, the cost efficiency ratio worsened in the third quarter, but this time, it was due to lower revenues. But what's important is we've actually begun to turn the corner on costs. Operating expenses and FTEs fell since the previous quarter, and headcount's now decreased by 5,000 since the peak in the first quarter of 2011.

And then thirdly, growth. We continue to invest for growth in faster-growing markets. We've increased revenues in Asia and Latin America, noticeably Brazil, versus the third quarter of 2010. And year to date, we've made good progress in repositioning Retail Banking and Wealth Management; and we've grown revenue from our wealth management products, mainly in Asia.

We've also expanded CMB in most markets, with overall revenues up 15% year to date versus 2010, within which Asia's up 25%, Latin America's up 35%, and the jaws are positive.

So to conclude, we're pleased with the progress on our strategy, but we recognize this is a long journey that we started in May. The external environment remains challenging, but HSBC remains strong, with a strong balance sheet and robust liquidity.

And we recognize that many of you hold the stock for the long term, and we remain determined to deliver on our goals by 2013.

Now Iain's going to walk you through the financial performance in detail and then we'll open up to questions. Iain.

Iain Mackay, Group Finance Director

Thanks, Stuart. You've seen the statements, so I'll cover a few of the key points in more detail. As Stuart said, the reported PBT for the third quarter and year to date are up, driven by movements in the credit spread and fair value own debt. Underlying profit before tax for the third quarter was $3 billion, down $1.6 billion in 2010, and is driven by a number of key factors; the decrease in revenues in Global Banking and Markets, as Stuart noted, adverse movements in the fair value of non-qualifying hedges. And this represents in the quarter an increase of $700 million over the same quarter last year; and an increase in loan impairment charges, mainly in North America, an increase in $700 million over the same period last year. This is partially offset by an increase in revenues in Commercial Banking globally of some $500 million.

Underlying profit before tax for the year to date was $14.4 billion, down $300 million in 2010, and reflects lower revenues in Global Banking and Markets, $1.9 billion; combined higher costs, which I'll go into in greater detail in a moment, of $2.1 billion; offset by significantly lower loan impairment charges of $1.8 billion, principally in North America; and growth in Commercial Banking revenues of $1.3 billion.

A little bit more detail on revenues. Reported revenues for the third quarter up $4.6 billion on the same quarter last year. And for a year-to-date basis, up $4.7 billion, in both cases driven by movements in the credit spread on fair value of own debt.

Underlying revenues were lower in the third quarter and year to date than in 2010. The main factors include the impact of the Eurozone sovereign debt concerns, depressing credit and rates revenue in the European area. Lower revenues in legacy credit, this is the ABS SIV portfolio; lower revenues when compared to the same period last year; lower balance sheet management revenues as previously indicated, again reflecting the maturity of longer-term maturities; and the inability to put paper back on at similar yields; and the ongoing run-off of the US consumer finance portfolios, which you'll recall is a relatively high-yielding portfolio on the net interest income line, but obviously high cost from a credit standpoint also.

Revenues increased in Commercial Banking in the third quarter and year to date compared to the same period, in part reflecting investment in this business, with higher net income driven by strong growth in customer loan balances.

A disappointing third quarter 2011 reported revenue performance in credit and rates offset a strong performance elsewhere in Global Banking and Markets. As Stuart remarked, six business segments posted three-quarter revenue growth of approximately 19% or more on the same quarter in 2010, with Global Banking and Markets benefiting from diversified client-driven business models with significant exposure to the faster-growing markets.

The underlying revenue was down against the second quarter, again reflecting Eurozone concerns; and notably, this is an important point, an adverse movement on non-qualifying hedges in the third quarter of $1.3 billion when compared to $300 million in the second quarter of this year.

Turning to loan impairment charges, we saw an increase of $700 million during the third quarter when compared to the same quarter last year. This came mainly in our run-off portfolio in North America, and reflects a significant increase in delinquency, deteriorating roll-rates, and an increase in severity; so increasing loss-given default if you like. And higher costs to obtain and realize collateral due to delays in the foreclosure activity. This effect is offset by lower balances. And when compared to the second quarter, loan impairment charges and other credit provisions rose by $1 billion, again, mainly in North America.

Despite the increase in the third quarter, on a year-to-date basis, loan impairment charges declined, primarily reflecting lower lending balances in the North American portfolios, and improvements in delinquency trends and collections in the United Kingdom.

Turning now to costs. Our underlying cost efficiency ratio was worse in the third quarter than the preceding quarter because of declining revenues. And year to date, our cost efficiency ratio worsened from 54.4% to 59.1%. Notwithstanding this deterioration, we began to see the benefits of our strategic programs beginning to deliver sustainable savings in the third quarter.

Despite restructuring costs of $200 million in the quarter, reported costs and headcount were lower than 2Q '11, with FTEs down 5,000 since the peak in the first quarter of this year.

Year-to-date operating expenses increased by $2.9 billion on 2010. This includes several notable items previously reported. Customer redress programs, mainly the PPI provisions in the UK, in total some $600 million on a year-to-date basis, restructuring costs of some $700 million, litigation expense of some $200 million, partially off-set by credit and defined pension benefit obligations in the UK of some $600 million.

Excluding these, the primary driver of the increase in 2010 was higher staff costs due to strategic investment and wage inflation in faster-growing markets.

Turning to the capital position, risk-weighted assets remained broadly unchanged, with a decrease of $9 billion, with exchange differences reducing risk-weighted assets by around $25 billion, partly offset by an increase of about $16 billion in risk-weighted assets from loan growth, mainly in our associates in Asia.

We continued to generate capital from operations. However, as a result of strengthening in the US dollar against a number of other currencies in which we operate, the core Tier 1 ratio reduced to 10.6% as of September 30 when compared to 10.8% at June 30.

With that, let me hand it back to Stuart.

Stuart Gulliver, Group Chief Executive

Thanks very much, Iain. So we'll now take questions, and the operator will just explain how the process works.

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Questions & Answers

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Alastair Ryan, UBS

A couple, if I may. First, looking at the balance sheet, quite a big step-down in trading assets and a big rise in central bank balances, clearly consistent with what HSBC's done in past times. But is that done, or is there more of that to come given the environment remains difficult? And was that move material to the P&L in the quarter? It feels like it ought to have been.

Secondly, in your description of what's going on at Household, it doesn't feel like a one quarter event. It feels like that long trend of declining P&L impairments has probably reversed for some time. So if you could give us a sense of how much catching up or getting ahead there was in the quarter versus underlying deterioration.

That's probably it for now. Thank you.

Stuart Gulliver, Group Chief Executive

Okay, Alastair. On the change from trading assets and the increase in balances at central banks, yes, it does reflect risk-aversion, and you've seen it before with us. But it doesn't necessarily explain the logic of the P&L move. So the Markets business in Europe shows up in the rates line, which you can see on page 23 of the IMS, obviously was impacted by the volatility that took place in Eurozone markets.

We're a primary dealer in 11 government bond markets in Europe. We've obviously reduced our exposure. You can again see that on page 21 of the IMS. So our exposure to European sovereigns, or these particular ones, has gone from $8.2 billion to $5.5 billion, within which we cut Italy from $4.6 billion to $2.5 billion.

But we remain primary dealers, and we remain primary dealers with obligations in respect of those sovereign nations and, therefore, it's exposure to the Eurozone that shows up in the rates number. The credit number in Global Banking and Markets is partly that the primary market's shut down, so therefore there wasn't a lot of customer business we could be doing; and partly there it's the absence of a positive from the previous year. In the previous year in the credit number, we had large revenues from ABS which didn't repeat this year. But what you're -- so therefore, the trading assets is, yes, risk-aversion; the increase in central bank balances is frankly the difference between -- it's partially the difference between having an AD ratio of 75, and your combined credit appetite for banks results in you leaving exposures with central banks, because essentially, you don't have the appetite to recycle it into the Commercial Banking credit risk market.

Alastair Ryan, UBS

Thanks. Just follow-on that then, Stuart, is there more of that to come? As things carry on, is the slice of September 30 in the midst of you doing something, so we'd expect that to be carrying on, or is September 30 representative of a position you're reasonably comfortable with?

Stuart Gulliver, Group Chief Executive

It's probably representative of a position I'm reasonably comfortable with, except this. We haven't seen a large inflow of deposits this time, I think because governments have put in place depositor insurance, so there hasn't been a significant inward migration. If there was a substantial inward flow of deposits, you would see an increase in those central bank balances, because by definition, if they're coming in I'm cutting my lines, and therefore I'm getting a lower AD ratio and I need to manage it.

And of course, this does have a negative NIM impact; but, clearly, the judgment we're making is we'd rather see a NIM compression than take principal risk.

Iain Mackay, Group Finance Director

So, Alastair, on the loan impairment charges in North America, there are four factors here. We saw increased delinquencies in the month of September. Now we've always experienced seasonality in this portfolio through the years. I think the increase we saw on delinquencies in September was more pronounced than the normal seasonality that we would expect to experience after the summer holiday period in the US.

The continuing decline in US residential property values, which we certainly see in our portfolios but is more broadly documented, for example in the Case-Shiller Index that's published every month, is therefore an aspect of our reserving. So it's loss-given default. As that builds up, then obviously reserving requirement for properties that are in default would be foreclosed upon and then sold on has an impact of incurred lost that's reflected in our reserving.

Another aspect which came in in the third quarter, and there is an aspect of year-to-date catch-up in this, is the cost of perfecting our collateral in the US has gone up significantly. One, the foreclosure process takes a heck of a lot longer than it did a couple of years ago. Two, what customers stop doing when they stop paying their mortgages, they stop paying their property taxes as well. And as you know, property taxes are a key feature of the US property market. So to perfect our title before we can then sell that property on, we have to pay the back property taxes.

So in terms of increasing legal costs and increasing back property taxes, that was a significant component of increased reserving in the third quarter.

The other element here is just the amount of time it takes to foreclose on properties to the extent there's any foreclosure activity going on, which is still really quite limited, affects the timing at which we would receive cash flows. And therefore, there's a discounting factor within IFRS, which again factors into the reserve.

So we've got basically a one-month step-up in delinquencies here. If I reflect momentarily on the October data, that would indicate a stabilization and slight improvement, but it's one month's data. So I think it's a little bit early for us to call any particular trend, either whether it's a sustained deterioration or whether it's a one-time reflection.

So I think, Alastair, though I'd love to be able to give you more at this time, there's not more to give you. So as we work through towards the year end, at the end of Feb, we'll be able -- we'll have a number of months' data and we'll give you a much better understanding of what's going on at that time, hopefully.

Stuart Gulliver, Group Chief Executive

Alastair, going back on the trading assets, just one other point of clarification. So the move from $474 billion down to $415 billion, that's $17 billion of it is FX, and the balance of about $41 billion is the change that I described.

Alastair Ryan, UBS

Thank you.

Stuart Gulliver, Group Chief Executive

Thanks. Can we get the next question, please?

Christopher Wheeler, Mediobanca.

I have three questions. The first question is just on the fair value adjustment on your own debt; just a minor technical point, really. It appears $3.1 billion is in Europe and about $1 billion is in North America. That seems a somewhat different mix than the normal 50/50 or 60/40 in favour of Europe. I just wondered if there was any particular reason for that. That's the first question.

The second question is on the Global Markets revenues, obviously very good in equities and security services. The credit probably as expected. But the rates number looks a little bit weak compared to your competitors, looking over how they've done in Q3. Any particular reason that you'd attribute perhaps under-performing in that area?

And then finally, if I look back at what the US retail banks have disclosed in terms of delinquencies on credit cards, consumer loans in their prime books in the third quarter, they've actually been on a downward curve. Now you were kind of a forward indicator of the problems in the subprime market. Do you think that we -- what you're actually seeing, what you've shown us today, which are quite marked upticks, is perhaps a warning to the rest of the sector, not just in your segment, but across the whole board in the United States?

Thank you.

Stuart Gulliver, Group Chief Executive

Thanks very much. On rates in Global Markets, I actually think if you dig into the numbers of some of our competitors, you'll find that they've used AFS routing for a lot of the mark-to-market stuff that we've taken directly through the trading P&L. I'm reasonably satisfied that we're not an outlier in terms of our performance in rates in the Eurozone when you actually look at the totality of the performance of European banks and look at how they've accounted for it.

And on fair value of own debt and the delinquency point, Iain will now answer comprehensively. (Laughter).

Iain Mackay, Group Finance Director

Yes. My favourite topic. Christopher, the fair value on debt, you've got the split more or less right, but it's very consistent with movements, both positive and negative, that we've seen in fair value on debt over the last five or six quarters, so there's nothing odd going on there. The underlying, obviously, is where we've got the principal issuances of debt, and that's obviously the European market, supporting principally Global Banking and Markets activities; and then, obviously, the finance company in the US, which was historically and continues to be funded by wholesale paper. So there's nothing particularly odd, as we look back over the last seven or eight quarters in terms of proportionality of the movements.

On the US Bank comps, a couple of things to bear in mind here. If you look at us and US mortgages, we have $50 billion of subprime mortgages in run-off. We're originating no new paper to those portfolios, and have not been since the first quarter of 2009.

We are not trying to dig into what other US banks are seeing, but I think the key feature here is that all the other principal players in the US have a broad base of super-prime, prime, Alt-A, home equity subprime loans. And at least in the super-prime/prime segments, they continue to originate new paper, presumably at the higher end of the credit spectrum.

So the picture -- we can shine a very clear light on our subprime portfolio, because it's pretty much all we've got, and the trends are, therefore, very clear. With the others, it's obviously a blended picture of new originations, a broader mix of credit quality within the portfolios.

But I do think if you sift through the press reporting, as some of the American banks came out, there's some indications that they're seeing some of what we see. But I wouldn't necessarily call us the canary in the coal mine here, but what we see I think is certainly reflective of some stresses in the subprime portfolio; and recognizing that some of our peers in the US have fairly sizeable subprime portfolios, it might not be a terrible shock if we see some of this later in the year. But again, the quarterly disclosures are fairly limited in this regard.

Christopher Wheeler, Mediobanca

Thank you very much. Very helpful.

Michael Helsby, Merrill Lynch

I've just got a couple of questions. Firstly, clearly, the third quarter's been very disappointing for most banks, and it's very comforting that you're sticking to your medium-term targets. I guess the question is, given the revenue outlook has clearly deteriorated, should we think of the trajectory of that recovery as being somewhat different from maybe what you'd have anticipated in May? And whether -- would it be reasonable to think the overall delivery of your targets could be delayed beyond 2013 at this point?

I guess the second question is on the US, and I think it's clear, from looking at the presentation that the deterioration has come from the old branch-originated loans, for all the reasons that you've just said, but the Cards business delinquencies ticked up. And I was just wondering if you could give us a comment on what you're seeing in Credit Cards, and if the situation deteriorated further, whether there's get-out clause for Capital One if they chose to renege on the agreement to buy that business.

Stuart Gulliver, Group Chief Executive

Okay. Michael, I'll take the first strategic question, and Iain will deal with delinquency in Credit Cards.

Yes, obviously, the external environment has deteriorated sharply since the May Investor Day, but I think you can see that we're continuing with tremendous intensity to execute on re-shaping the firm.

And as to the financial targets that we set out there, to be honest, I want to stick by them, but I think we're going to clearly be at the softer end of the target. So where we said 12% to 15%, it's kind of going to be 12%; and where we said 48% to 52%, it's going to be 52%. So where I want to flex it is in moving to the end of the ranges, not in abandoning them. Okay?

Because if you look at it in another way, we've been doing this since May, so it's only like five months, and we've run into a very difficult quarter that's primarily due to elevated LICs in the household business, and the Eurozone crisis. You can put aside the non-qualifying hedges.

I don't think we should be shaken off our strategic intent because there's a difficult operating quarter. I've got to reshape this firm. I intend to still do it. And we set ranges frankly to give us this kind of flex.

So, yes, as we sit today, I still want to get a 12% ROE on an underlying, not a reported basis; so not using the fair value of own debt to sort of juice it. And I still want to get to a 52% cost efficiency ratio.

Iain Mackay, Group Finance Director

On the Credit Cards, Michael, looking at the trends there, there's a very, very, very slight uptick in delinquencies in the third quarter in Credit Cards, and that is essentially the seasonality that I referred to that we've seen year after year, both in our credit cards as well as our mortgage portfolios.

The difference here is that the US customer is very much focused on maintaining the utility of their credit cards, whereas I think there's an aspect of moral hazard around the ability to stop paying and not being foreclosed. But we will dig into that and update more later.

On the disposition of this Credit Cards business, this is a very tight contract; there is no get-out clause. I think the prospective acquirer Capital One really likes this portfolio of business. It fits very nicely into their setup. And the underlying performance of this business; strongly profitable, very attractive cost efficiency ratio, good returns on invested capital and equity. So a very slight seasonal tickup in delinquency this year I don't think is going to scare them away.

Michael Helsby, Merrill Lynch

Thanks. Can I just ask one more question? Could you just pull out for us what the underlying loan growth was on an annualized basis in the third quarter? So that's adjusting for the FX movements; and obviously, you've reallocated the US business.

And I think everyone's read your comments, Stuart, about the Asian credit crunch reported in the FT. I was wondering if you could just give us a little bit more color on what you meant.

Stuart Gulliver, Group Chief Executive

Yes, sure. While the guys get to those numbers for you, so look, our research team out here has done a bit of work, and bank credit to GDP in Asia is back to the levels it was in 1997. So bank credit as a percentage of GDP is back up to the levels of leverage that we saw pre the Asian crisis. So that's point number one.

Against that, Asia's got effectively a structural AD ratio as a community that's actually probably at about 85%. So probably, the amount of savings in this part of the world could actually fill that gap. But within that big jump in bank credit to GDP, the biggest contributor to it is European banks. So European bank lending into Asia has increased massively in the 2004 to 2010 period.

So what I was essentially saying is, given that we've reached the original peak, because of course it fell really sharply after the '97 financial crisis, but now it's mostly made up of European banks, is there a vulnerability there? And the reason I can't actually definitively say there's a vulnerability is we can't get under the data to see if that European bank lending in Asia is to Volkswagen, i.e., a European company, or it's to X, Y, Z, property developer in Hong Kong or Singapore, or whatever.

So my point therefore is if the Eurozone crisis results in a number of European banks having to withdraw to their national sovereign borders, which as we saw in 2008 is what banks do if they're in need of support from their governments, funnily enough the taxpayer, the voter wants them to extend loans at home, not overseas, there could be a vulnerability in Asia.

There is no sign of it, and it could be much less pronounced if either, A, that represents lending to Volkswagen; or, B, the large surplus that exists in Asia is recycled effectively through local insurance companies back into the credit market through fixed income. But that was the point I was making.

Michael Helsby, Merrill Lynch

Okay. Very clear.

Iain Mackay, Group Finance Director So, Michael, to come back to the loans and advances. If we strip out the foreign exchange effect and the reduction repo activity, our loans and advances to customers are down about 1% when compared to the June 30 close-out. Okay?

And if you then go across to customer accounts, we're maintaining a growth trajectory overall in customer accounts which is partly the explanation for improvement in the AD ratio. But the other, as you've noticed, is the re-class of the assets in the North American portfolios that are held for sale now.

Michael Helsby, Merrill Lynch

Okay. So is that a shift in your risk appetite on a forward-looking basis, given everything that's going on? So should we expect quite a sharp slowdown given you've grown loans, particularly in Asia, extremely rapidly in the last 18 months?

Stuart Gulliver, Group Chief Executive

Well, what we've done in Asia, basically for the last three/four months, is to start to write business on the assumption that we will see a normalization of loan impairment charges, because they've been abnormally low, and therefore we also have assumed that therefore internal credit risk ratings will deteriorate.

So we've started writing business, effectively stress test for a couple of notch downgrades, assuming that the business will still hit our ROE thresholds. And that by definition will slow the growth. It also means that we'll only be writing profitable business, and probably to the best credits.

So I wouldn't see it as an abrupt stop by any means, but we clearly have slowed the pace having done it at a very fast clip. But there will still absolutely be growth in places like Latin America, Hong Kong, Rest of Asia Pacific. But I've basically tightened the lending criteria, and I tightened the return criteria about three months ago.

Michael Helsby, Merrill Lynch

Okay. That's very clear. Thanks for all the questions. Thank you.

Stuart Gulliver, Group Chief Executive

Thanks. Next one, please.

Ian Gordon, Evolution

Could I ask you just to add a comment on the Hong Kong revenue performance? I note your comments in the script on market valuation changes on insurance, but more specifically, can you also comment on the asset margin developments, especially given your comments on your change in risk appetite in that region?

And then just a couple of other housekeeping points. Apologies if I've missed it, but have you said anything new on the Basel 2.5 impact at year end? And I noticed balance sheet management revenues held up reasonably well as you guided to at the half year. Any update on your outlook for that line?

Thank you.

Iain Mackay, Group Finance Director

Yes. Ian, if I take the net interest margin first. In Asia Pacific, we've actually expanded net interest margin in the quarter, and part of that's reflected in asset re-pricing. But also, we've had a little bit of help from the liability side of the balance sheet where we've seen policy rates in a number of countries in which we operate pick up and help us on that front.

But we have been able to expand margins on the asset side. And, as a net result, within the HongKong Bank Group, we've expanded net interest margin year over year by some 6 basis points, and quarter over quarter by about 9 basis points.

So I think that's the story on the net interest margin.

Stuart Gulliver, Group Chief Executive

On the rest of the stuff in Hong Kong. Yes, there's a change in insurance accounting. There's also the fact that the stock market fell in the third quarter quite considerably, which basically then has a kind of depressive effect on Wealth Management revenues in Hong Kong.

The Hong Kong Wealth Management business is very geared to the equity market, as of course is the retail broker, the institutional broker and the custodian business. So there's three or four levels of exposure to the same effect.

And then we've also seen a specific loan impairment charge on a Commercial Banking customer in Hong

Kong and the start of normalization of loan impairment charges generally, because they've obviously been running at abnormally low levels.

On balance sheet management, yes, it has -- it's done slightly better than we guided. I still think that the guidance for 2012 should remain $2.5 billion, because I'm not optimistic that we will see rates move up at all. And of course, what we're doing is we're taking advantage of any curvature that appears from time to time, but I can't predict when that curvature will appear and how quickly it will disappear again. So I think $2.5 billion, which is what I've been guiding for some time, is the right kind of level to have in a model for 2012.

Ian Gordon, Evolution

Thanks. And, sorry, just the other one was Basel 2.5. Was there any change?

Iain Mackay, Group Finance Director

Oh, right. Sorry. No, in terms of what we talked about in some detail back in May, Ian, there's no real update at all. We're obviously revisiting this on a continuous basis. So there's nothing of significance to update on that front.

Ian Gordon, Evolution

Okay, thanks very much.

Ian Smillie, RBS

Two lines of question, please, the first one on GBM. Quarter on quarter, the revenues were down just over $1 billion, and costs were down by just less than $100 million. So I guess the question is, could you give us some sense of what bonus accrual was taken inside Q3, what prior period amortization was taken inside Q3, and what stock of unamortized deferred comp is still sitting on the balance sheet to come through in future quarters, please? That's the first line of thinking.

And then on the second one, if we look back at the one-off portfolio P&L impairment in the US, it looks like of the $1.8 billion P&L impairment taken in 3Q there was about a $0.8 billion reserve rebuild of the credit loss reserves. So the question is, when looking forward, would you encourage us to think about further credit loss reserve rebuild on that shrinking book, and therefore the $1.8 billion is kind of the new level to think about? Or was that a one quarter event and the underlying $1 billion would be a better number to think about going forward from that book, please?

Iain Mackay, Group Finance Director

Okay. Stuart, I'll take the bonus, and --?

Stuart Gulliver, Group Chief Executive

Yes.

Iain Mackay, Group Finance Director

Okay. So on the bonus front, Ian, what you see coming -- amortizing through in terms of previously deferred periods for compensation is consistent quarter over quarter. And I think we've talked about it across the piece as being somewhere in the range of $240 million to $250 million for the Group.

When you look at the effect of declining revenues on our accruals in the third quarter, as you can imagine, we reduced the accruals significantly.

The goal overall from a payout perspective will be to maintain reasonably consistent payout ratios based on the level of profitability when compared to last year. And as you know, we tend to be at the lower end of the payout when it comes to variable compensation within our Global Banking and Markets business.

So we're maintaining the very same principles. There are deferred components within the compensation, and it is absolutely linked to the level of profitability generated within the business. And the payout ratios broadly speaking will be consistent. So as a consequence of third quarter performance, you can imagine that the accruals came down quite significantly.

Stuart Gulliver, Group Chief Executive

From a loan impairment charge perspective, I'm not sure I would add anything more to the answer that I provided a little bit earlier, Ian. As you quite rightly point out, we had an uptick of some $800 million in terms of loan impairment -- in terms of the build on the reserve. That was a direct reflection of the factors which I'd highlighted in the response to earlier question.

And in terms of whether it's a sustained uptick, or whether it's a one-time event, I think the same story. There is an aspect within which we did in the third quarter around costs to obtain and perfect collateral, which was more of a catch-up.

But the other aspect, I think it's too early to say. In the month of October, we saw very much a stabilization, a slight improvement. But having had a long history in this business, I tend not to get carried away with one month's worth of data.

So September was clearly a difficult month in terms of delinquencies. October represented some improvement. But as you can well imagine, we will keep a very close eye on what we're seeing in this regard, and once we get a couple more months of data under our belt, and as we talk about this at the end of February in our full-year results, we'll hopefully be able to provide you a much clearer picture.

I think what concerns us is the fact that there is still not an agreement in place with the five major US banks around foreclosure activities, and I think until that is reached, and as a consequence of that foreclosure activity gets going again, we believe that what we're observing is an aspect of moral hazard within the customer base. But it's too early to draw conclusions at this stage.

Ian Smillie, RBS

That's very useful. Thank you both.

Stuart Gulliver, Group Chief Executive

Next question, I think.

Steven Hayne, Morgan Stanley

Two questions to start with, please. Don't know if I'll get time for any more, but question number one, you alluded to a change in insurance accounting, and I can see from the 3Q number that the insurance claims at the Group level decreased significantly. So it was running at $3.2 billion in the second quarter and dropped to $1.6 billion in the third quarter. I'm just wondering if you can guide us as to whether that is a more sustainably lower level, or that was somewhat of a one-off. That's question number one.

Number two on the core Tier 1, it went down marginally. I understand there's some FX in there, and I was just wondering if you could expand on that point, because I always understood core Tier 1 was that you hedge both sides, so it shouldn't affect -- you shouldn't expect anything on the regulatory capital due to FX, but we have had that this quarter.

Thank you.

Stuart Gulliver, Group Chief Executive

Okay, Steven. The insurance impact. This relates to insurance contracts with discretionary participation features in them, principally within the Asian markets. And the liability and claims line is directly linked to the movements within the equity markets. So as the value of those funds go up, the degree of participation by the policyholders goes up with it, so our liabilities and claims goes up in line.

As the equity markets go down, there are two aspects for us. On assets under management we earn lower fees. There's less participation in terms of equity gains, but by the same token, that proportion which then reverts to customers with discretionary participation features goes down as well.

So that's the main movement that you see going on in the insurance lines over the course of this quarter. So it's very tightly linked to the movements in equity markets.

On core Tier 1, to go through some of the key elements on that, in the quarter, we continued to generate capital from operations to the tune of some 20 basis points. Dividends net of scrip picked up about 13 basis points of that.

However, within the capital base, our capital is expressed in the currency, the functional currency of the main subsidiaries around the world, and that's obviously not all in US dollars. And generally speaking, the risk-weighted assets in those same businesses is denominated in a corresponding functional currency.

However, what we do have in a number of our principal operating subsidiaries are, let's say take Mexico for an example, we've got a broad base of business in the Mexican peso, but we've also got a fair bit of US dollar underwritten business. The same happens to be the case in the Eurozone where we've got the functional currency being the euro, or sterling, but business written in US dollars.

So within a number of our books we have a degree of mismatch, if you like, between the structural FX position which reflects our investment in that subsidiary, versus the risk-weighted assets within that business. And as a consequence, we are somewhat subject to movements in -- both up and down in the capital base as a consequence of some of that mismatch.

This is something we monitor very closely on a monthly basis through our ALCO committees, and if you track back, you'll see that we will have benefited as well as had some of the deterioration in the capital ratio. And that's one of the reasons that we carry buffers.

But from a systemic standpoint, we try to match the investment with the underlying risk-weighted assets closely, and where we don't, and where the opportunity and early warning if you like is there, we try to hedge it with FX forwards.

Steven Hayne, Morgan Stanley

Thank you. Can I ask one very quick one around --?

Stuart Gulliver, Group Chief Executive

No, I'm afraid you can't. I'm sorry, you can't, because there's 18 minutes to go, and nine other people waiting.

Steven Hayne, Morgan Stanley

Fair enough. Thank you.

Stuart Gulliver, Group Chief Executive

Thanks, Steve.

Iain Mackay, Group Finance Director

Sorry about that Steve.

Stuart Gulliver, Group Chief Executive

Okay, can we get the next one, please?

Ronit Ghose, Citigroup

I just wanted to follow up on your interesting comments about loan growth in Asia. You said a lot of that was driven by European banks. Do you have any data or color as to whether these are French banks, German banks, or even UK banks? That would be question number one.

Related question on the Hong Kong loan book, and ties into your earlier comments, the corporate and commercial segments, seems a small dollar decline in loan balances. Is this just seasonality, or is this part of the slowing down of the tightening up of the credit quality we discussed?

And the other question is again tying into what Iain just said on insurance. I saw, as to the last question, the insurance claims and liabilities line halved, the negative halved. I'm just wondering, is there an offset in the net income from other financial instruments line that the liabilities negative goes down but there's also an asset negative change as well?

Stuart Gulliver, Group Chief Executive

On the first one, in terms of the nationality of the banks, I don't have that to hand. But what I will do is I'll get the macroeconomic guy who did the research for me in contact with you.

Ronit Ghose, Citigroup.

Thank you.

Iain Mackay, Group Finance Director

And looking at Hong Kong, there's a number of segments in which we continue to grow the book. However, within the Commercial Banking segment, we saw a reasonably marginal decline, particularly as it related to trade-related lending balances, which is both a reflection of the change in appetite that Stuart talked about a couple of questions ago, and also a reflection really of a somewhat slowing effect in terms of growth which I think is some reflection of what we see in mainland China.

Stuart Gulliver, Group Chief Executive

There was also a technical aspect to it, because there was a lot of letters of credit being written against RMB borrowing, which the HKMA then basically ruled against. So there was a whole trend going on of effectively cross-border financing which the HKMA put paid to. So you'll see that across the sector. And that actually explains a large amount of that move.

Ronit Ghose, Citigroup

Okay. And the last one was on insurance. The net insurance claims line that halves from $3.2 billion negative to $1.5 billion. Is there any offset in the line item that goes from $103 million to negative $1.6 billion?

Iain Mackay, Group Finance Director

Yes.

Ronit Ghose, Citigroup

Right. We should consider those two line items together, right?

Iain Mackay, Group Finance Director

Very closely correlated, yes.

Ronit Ghose, Citigroup

Okay, thank you.

Stuart Gulliver, Group Chief Executive

Okay, thanks. Can we get the next one, please?

Robert Law, Nomura

Three brief questions, please. Firstly, there normally is some cost increase seasonally for you in Q4. Would you expect that to happen again?

Stuart Gulliver, Group Chief Executive

No, I'm going to be really, really watching that, because we can recognize exactly the same phenomenon that you're saying. And clearly, if I'm signalling that I think we've turned the corner on costs, we're going to do everything we possibly can to make sure that that kind of frankly padding that may have taken place from time to time in our shop doesn't take place this year.

Robert Law, Nomura

So if we look at the near $10 billion you reported this quarter, that could be a representative number we could use as a base?

Stuart Gulliver, Group Chief Executive

Yes I would hope so to be honest, Robert. I'm acutely aware of exactly what you're saying, and clearly, I'm trying to turn rather a large ship here. But, yes, I'm determined that this has signalled the turn of the cost base.

Robert Law, Nomura

Okay, great. On non-qualifying hedges, could you enlighten us as to how we should think about that? Is there an offset in the revenue line? Should we genuinely strip it out? Is it a non -- almost like own debt in that sense?

Iain Mackay, Group Finance Director

Well, I think you should absolutely strip it out, Robert.

Stuart Gulliver, Group Chief Executive

I think you should add it back to the revenue, actually.

Iain Mackay, Group Finance Director No, I think, look, what we've got here is an accounting asymmetry, and as you probably know, the NQH are in two broad categories. One which is hedging the extension of tenure in the US mortgage book as it runs off; and the second is on debt issued at the Holding Company in euros and sterling swap-back into our reporting currency, the US dollar.

The most marked effect is in the US, and the principal effect that you see of $1.3 billion in the quarter is I think a reflection of project or program twist, or whatever they called it, which was the flattening of the longer term of the US yield curve.

So interest rates presumably can't go negative. They're pretty much where they are. So this is something that from an economic perspective, the underlying assets which are -- the underlying economics of what's being hedged is on an accrual amortized cost basis, Robert, whereas the non-qualifying hedge is clearly a mark to market.

So we've got a bit of an asymmetry in the accounting, but one of the things that we review every single month is the continued effectiveness of these hedges from an economic perspective, whilst recognizing that we've got to deal with some asymmetry in the accounting. But we're very satisfied that we've got that economic hedge in place and that it's working effectively.

Robert Law, Nomura

Okay. The final thing was, could I ask you to expand a bit on the comments you reportedly made, certainly on the press wires, about the domicile, and the ICB? Are you effectively saying that if the costs continue to look as they now appear to you of $2 billion to $2.5 billion, that you'll essentially have no alternative but to move the domicile?

Stuart Gulliver, Group Chief Executive

What we're saying, Robert, is that first of all, we don't know what whether the Government will actually implement the PLAC recommendations in the ICB report as they're currently configured. And until we know exactly what the Government intends to do, we can't really get drawn on a decision because we don't have enough facts to make the decision with.

What we're also saying, however, is that the Board is acutely aware that its fiduciary duty is to its shareholders. And really, we're trying to make those two if you like quite separate, but obviously somewhat linked points. And I can't go beyond that because I don't know what the legislation will say by the time the legislation is introduced.

I fully expect the competition stuff to be there; that's fine. We operate in Hong Kong where there are 186 banks for 7 million people, so the competition's fine. The ring-fence would not be frankly our first way of tackling this issue, but if that's the way the UK goes, that's probably fine, although I doubt if it will show a cracking ROE against its cost of equity.

But the PLAC is difficult for us because it's kind of odd. We've got an AD ratio of 75%; in our view that gives us an incredibly strong conservative balance sheet. But because we've got an incredibly strong conservative balance sheet we need to go and leverage it up by issuing $55 billion of senior bonds we don't need, or don't want to then go and buy $55 billion probably of gilts that we don't want. And obviously, the carrying cost on that is about 400 basis points; 300 basis points on the issuance side, 100 basis points on the other side. On $55 billion, that's where you get to the $2 billion to $2.5 billion number I'm talking about.

And actually, clearly, possibly the work that was done within the ICB report and you'd need to talk to Bill Winters and so on about how this came about, is very helpful if you're JPMorgan and clearly -- or fits to JPMorgan's balance sheet, and it's very helpful for those banks that have AD ratios over 100, which of course in the UK, is everyone other than us and Standard Chartered.

So we do feel actually that there's an unfortunate consequence to this. We don't know whether this will become law. If it does become law, all we're signalling is that the Board is absolutely aware that its fiduciary duty lies with the shareholders. And I don't want to get drawn more than that because I don't know where this goes for the time being.

And what we have also said, Robert, is we're therefore not going to make a decision at the Board meeting at the end of November, which is where we would typically have the tri-annual review of where the headquarters is. We just don't have enough data points to make an informed decision. So we'll add that to a Board meeting at some time in the future. It might not even be 2012, depending on how quickly this thing moves ahead.

Robert Law, Nomura

Fine, thank you very much.

Raul Sinha, JPMorgan

Just a couple of questions, firstly on the PLAC. Can I assume that the estimates that you cited are basically assuming that the PLAC applies at Group-wide rather than to the UK?

Stuart Gulliver, Group Chief Executive

Correct. That's correct.

Raul Sinha, JPMorgan

And then secondly, if you look at the trends within Household, not only were impairments up significantly, but also the revenue was negative in the quarter. And is that because of the higher legal costs that you talked about? And should we expect -- are there any big one-offs within that? Should we expect that to continue?

Iain Mackay, Group Finance Director

The revenue effect is the NQHs. It gets booked to net trading income, Raul, so you clearly have declining revenues as that book of business runs off. It's a fairly high-yielding book of business. But the significant one-off negative was the non-qualifying hedges. That's the principal effect here.

And in terms of the underlying LICs and trends, there's nothing really I can add to what I've already said.

Raul Sinha, JPMorgan

Right, so just to clarify, the negative $109 million in your Consumer and Other, which is basically the retail portfolio within the US, includes this impact of non-qualifying hedges?

Stuart Gulliver, Group Chief Executive

Yes, it does.

Iain Mackay, Group Finance Director

That's correct.

Stuart Gulliver, Group Chief Executive

That's correct. That's what makes it negative.

Raul Sinha, JPMorgan

Right. Just one final question. Can you comment on the underlying loan growth of the Group ex associates?

Iain Mackay, Group Finance Director

Ex associates quarter over quarter, excluding the effect of a declining repo book, were actually down about 1% quarter over quarter. And year over year -- is that one here? We'll come back to you on that one, okay?

Raul Sinha, JPMorgan

Thank you.

Stuart Gulliver, Group Chief Executive

Thanks very much. Can we take the next one, please?

Tom Rayner, Exane BNP Paribas

I'd just like to go back quickly to the reserve build against the run-off book in the US. The cover ratio, if I'm correct, at 72% does look conservative for what is still primarily a mortgage book. I know the quality of those mortgages is questionable, but 72% does seem quite conservative. I'm just wondering if moving the reserves to this level indicates some other concern.

And your comment about changing customer behaviour interests me. Are you expecting any change in behaviour which causes a big spike up in delinquency from here, or is there something else within that comment that I should be looking at?

Iain Mackay, Group Finance Director

Tom, it's a good question. I wish I could say more than I've already said on the previous questions. We saw an uptick in delinquencies. We've always maintained a conservative reserving position with respect to this one-off portfolio, principally in reflection of the difficulties in the US property market and fact that foreclosures are potentially affecting payment behaviour.

We've got to keep an eye on this, and we'll give you whatever we've got, and it will be great, it will be more detail when we report out for the full year in February. Okay?

Tom Rayner, Exane BNP Paribas

Okay, thanks. And just on the revenue point, when you strip out those hedge effects on the revenue, it's still down on the quarter I think 7%/8%. Is that pretty much in line with your expectations, or is anything affecting the revenue as the book runs off versus pre budget, if you like?

Stuart Gulliver, Group Chief Executive

No, it's the run-off of the book. These, remember, were very high-yielding assets that then were entirely taken out by the loan impairment charge before they hit the bottom line. So as those books -- as the book runs down, that revenue will run down.

Tom Rayner, Exane BNP Paribas

Yes, sure. And just finally from me, the comments you've made, Stuart, on European banks possibly pulling out of Asia, do you see this as a risk or an opportunity, if it is in fact the case?

Stuart Gulliver, Group Chief Executive

It should be an opportunity for us; it should be an opportunity. I think in this phase of I guess what is now a four/five-year-old crisis, I think that the opportunity for market share gain is likely to be in Global Banking and Markets and Commercial Banking. Because governments have provided depositor insurance, it's unlikely that we'll see a massive inflow of retail deposits as we did in 2008. I think the opportunity now will far more be in Commercial Banking than Global Banking and Markets.

Tom Rayner, Exane BNP Paribas

Okay, thank you very much for that.

Stuart Gulliver, Group Chief Executive

Thanks. Next one, please.

Rohith Chandra-Rajan, Barclays Capital

I'm just wondering if I could very briefly just come back to the volume discussion, particularly Rest of Asia Pacific where the dollar balances were flat but the commentary talks about continued underlying growth. Wonder if you could scale that particularly with reference to the mid 20% annualized growth we saw in the first half.

And then more broadly, just at the Group level, any comments that you have on the Group margin. You talked earlier about some positive moves in the Asia region. Just wondering what you're seeing at the Group level.

Thanks.

Iain Mackay, Group Finance Director

In terms of the underlying on the quarter, it's up 5%, right? Yes. So in terms of continuing growth within loans and advances to customers within Asia, we're up 5%. But again, reflect on what Stuart mentioned.

Stuart Gulliver, Group Chief Executive

You've got really FX moves as well in Rest of Asia Pacific. Don't forget the Indian rupees weakened a lot, so has the Sing dollar, so has the Philippines peso. And of course all of this is translated in US dollars. So in local currency terms, there is growth.

So the PBT and the comment about growth is not inconsistent with what you're seeing. What you're seeing is a dollar translation of local currency.

Rohith Chandra-Rajan, Barclays Capital

So, sorry, the plus 5% in the quarter was on a dollar basis or a constant currency basis?

Iain Mackay, Group Finance Director

Constant currency, excludes the effects of FX. Okay?

Rohith Chandra-Rajan, Barclays Capital

Yes, thank you. And then just on the margin?

Iain Mackay, Group Finance Director

In Asia?

Stuart Gulliver, Group Chief Executive

No, at Group level.

Rohith Chandra-Rajan, Barclays Capital

No, you talked about Asia before; just the Group level, any commentary?

Iain Mackay, Group Finance Director

All right. Yes, gladly. One second. From a net interest margin perspective overall for the Group, quarter over quarter pretty much stable. We're down 2 basis points; actually up when compared with the first quarter; flat with the fourth quarter of last year. So overall on a Group basis, we're more or less flat over the last three quarters. We're down a few points when compared to the same period year to date last year.

That's characterized by some compression in the UK, particularly in the liability side; expansion in Hong Kong, the broader Hong Kong and Asia as we discussed earlier; North America holding reasonably sound on a declining high yielding book of business, principally because the cost of funds is extremely well managed at a low level; Middle East pretty much flat; and then in Latin America down ever so slightly.

Rohith Chandra-Rajan, Barclays Capital

Okay, so the main moves are really of the UK and the Asian businesses?

Iain Mackay, Group Finance Director

That's correct.

Stuart Gulliver, Group Chief Executive

They're the big volume balance sheets.

Rohith Chandra-Rajan, Barclays Capital

Okay, thank you.

Stuart Gulliver, Group Chief Executive

Thanks. Next one, please.

Arturo de Frias, Santander

Two quick ones, please; one on GBM and one on retail. On GBM, I know we spent a lot of time last May talking about re-sizing the business and re-thinking the overall size of the Group, including GBM, etc. But as you said at the beginning of this call, things have changed quite substantially and the outlook of the environment is now much more complex than what it was last May. So my question is, are you re-thinking, or too early taking into account the losses in rates and credit etc., but do you feel you need to re-think again the size of GBM?

Stuart Gulliver, Group Chief Executive

No, I don't. I still think that the GBM business for us should be between 30% to 40% of the PBT of the Group through the cycle. And I think that we have such a unique set of geographic footprints which has informed this strong growth in FX, equities, payments in cash management and security services, which I think you'll find it hard to see in other global banking and markets businesses, that we need to keep with that end aim of 30% to 40% of PBT.

Now, that's not to say that we might not do some fine tuning within the European space. By definition, if there's going to be a single European bond market, then by definition, there's 11 primary dealerships that won't be as necessary in future if Europe's just going to issue bonds as Europe. Clearly, as a Spanish person, you may have a better feel for me whether that's physically ever likely to happen.

Arturo de Frias, Santander

No, I don't.

Stuart Gulliver, Group Chief Executive

No, neither do I. And also, I don't want to change my strategy because it's been a quarter of difficult markets.

Stuart Gulliver, Group Chief Executive

So on retail?

Arturo de Frias, Santander

Yes, on retail, obviously most of that weakness is US, but there is also a clear weakness in Europe and in Hong Kong. Europe retail is down around 30% year on year; PBT I mean. Hong Kong retail is also down around 15% broad numbers PBT. How much of this is structural, if you want, or how much of this is more created by the current environment? Particularly taking into account that rates will be low for much longer and consumer confidence and lack of growth and deleveraging and so on and so forth, do you think this weakness, which is I think pronounced in European and Hong Kong retail will continue?

Iain Mackay, Group Finance Director

If you look at the European Retail Bank on an underlying basis, we've actually progressed the profit before tax when compared to the same period, Q3 2010, Q3 2011. And what underpins that is a pretty robust performance by our Bank in the United Kingdom, both with respect to Retail Bank Wealth Management and Commercial Banking.

So I think in Europe overall that the trends within Retail Bank Wealth Management and Commercial Banking are fairly sound.

Looking at Hong Kong, and I think we'd addressed this a little bit earlier, the effect in Hong Kong was largely driven within the wealth management space as we saw the values of equities come down. Clearly, our fees for assets under management come down with that. Some of the profitability through the Insurance businesses and gains in investments come down with that as well.

So it's very much related to equity movement, and again, the Hong Kong business on an underlying basis continues to be pretty strong. So for example, quarter over quarter, again, we continue to generate more than $2.2 billion worth of profit before tax.

Arturo de Frias, Santander

Okay, thank you.

Stuart Gulliver, Group Chief Executive

Next one, please.

Sally NG, CICC

Thank you. Just a very quick question. A number of US and major European companies actually disclose the gross and the net exposure to the GIPS. I was just wondering, I suppose your disclosure here is gross exposure. Just wondering whether you could touch a bit on how much that will have been brought down by the collateral and the hedges.

And I guess a related question is how you see the current Italian bond yield situation, where you see that going.

Stuart Gulliver, Group Chief Executive

I honestly don't have a view that I would want to share on this call as to where Italian bond yields are going and what's happening in Italy. Since I've been on this call, the Italian markets sort of sold off dramatically since we started the IMS process. And to be honest, Sally, for the last 4.25 hours I've been in this room. So I don't know what's been happening with the Italian bond market this afternoon, and I don't think it would be helpful for me to therefore wing an opinion to you.
On terms on net positions and gross positions --

Iain Mackay, Group Finance Director

We generally have not disclosed that information. We've obviously provided the detail of net exposures to governments and agencies on page 21 of the IMS, and obviously have moved those exposures down significantly over the last 90 days from $8.2 billion down to $5.5 billion. I think that's the broad extent of our exposures, and are therefore managing to that risk position.

Sally NG, CICC

Okay. All right, thanks.

Stuart Gulliver, Group Chief Executive

Thanks, Sally. Next one please.

Mike Trippitt, Oriel Securities

Just a quick question back on these non-qualifying hedges. I'm just trying to think of the mechanics of it now as we go into Q4 and beyond. Should we look at the Q3 adjustment as a one-time reset based on how the yield curve's moved, and going back to your point being about program twist and what that did to the long end of the curve?

Or if we stay in this position, do we continue to see negative impact on that line going forward? Is it a one-time adjustment, or is there a recurring impact?

Iain Mackay, Group Finance Director

It relates directly to the long-term interest rates on those hedges. So if you go back over the last seven quarters, we've had varyingly five quarters of negative movements -- sorry, six quarters of negative movements, and one quarter of incredibly strong positive movement. So it will relate directly to the movements in the underlying long-term US interest rates.

If rates remain largely where they are, you'll see very little movement. And if I talk about what we saw in October, we actually saw a positive movement on the NQHs as it relates both to our North American hedged mortgage portfolio as well as the holdings there.

So this is a number of which it would be unfair to say that we view it purely as a non-relevant item, but we do revisit the effectiveness of the economics of the hedge and deal with the volatility in the accounting. So I'm not sure I can actually say a great deal more than that.

Mike Trippitt, Oriel Securities

No, but you've answered it hypothetically; if the yield curve doesn't move, then effectively the NQH doesn't move either. It's now going to be on subsequent moves. Yes, okay.

Stuart Gulliver, Group Chief Executive

Yes, Mike, actually the other way of thinking about it, Mike, is if rates continue to go down, it will continue to be negative, or get to a bigger negative number, until of course rates hit the zero band when it can't get any worse.

I think the other direction, it could go up and create an enormous profit, which you should also ignore.

Mike Trippitt, Oriel Securities

Ignore. Yes, sure.

Stuart Gulliver, Group Chief Executive

Okay, thanks. Thank you. Can we get the last question which is Alistair Scarff?

Iain Mackay, Group Finance Director

Alistair Scarff's been incredibly patient.

Alistair Scarff, Bank of America Merrill Lynch

Thank you, Iain; thank you Stuart. Just a very quick question relating to asset quality across the APAC region. We've seen some disappointing numbers coming out of the Indian banks, concerns on the Thai -- Indonesia. It does seem that the inflection point has happened. Could you give some colour as to what you're seeing within your portfolio, since you are obviously a broad footprint across that? That would be great.

Stuart Gulliver, Group Chief Executive

Sure. So far, we have not seen any significantly elevated trends. What we are seeing is there's one or two specific impairments; one in Hong Kong in Commercial Banking, one in Singapore in Global Banking and Markets. But aside from that, what we're seeing really is a normalization of our loan impairment lines back towards the kind of levels that we probably saw in 2010. But we're not seeing anything that at this moment in time would give us the canary in the coal mine type of signal at all.

Alistair Scarff, Bank of America Merrill Lynch

Great. So in terms of if we're looking at India, given you highlighted it as a key growth area that you'd like to be bigger in, the recent numbers and trends over the last two quarters, which has given [inaudible] concerns on the Indian banks a bit of a shock, you're not seeing that within your portfolio at this stage?

Stuart Gulliver, Group Chief Executive

No, our Indian numbers actually look pretty good. In fact, we've seen lower LICs in Retail Banking and Wealth Management in India. Clearly, that -- if you remember, we had a problem with the Card business there a couple of years back, but that continues to go well.

And actually, the PBT of our Indian business is pretty good over the first three quarters of this year; it's very strong. So we haven't seen this at all in Global Banking and Markets and Commercial Banking, or in RBWM.

Alistair Scarff, Bank of America Merrill Lynch

Fantastic. Thanks, gentlemen. Thanks for your time.

Stuart Gulliver, Group Chief Executive

Thank you very much indeed. Okay, if there's anyone left on the call, what I just want to do is just to recap.

So, look, the third quarter's been pretty difficult for the industry, and obviously it has for us as well. However, despite these headwinds, we've increased our focus on our strategy. Clearly, we've upped the pace of change, and I think we've made real progress in implementing what we outlined to you back in May.

Now we've announced 14 transactions year to date, 11 since June 30. We have begun to turn the corner on costs. Operating expenses and FTEs have fallen in this quarter from their peaks earlier in the year. We continue to invest for growth in the faster growing markets. Remember, this strategy is not just about cost cutting. And you can see in Commercial Banking and in numbers in the rest of Asia Pacific, actually in the Middle East and in Latin America, actually results coming home on those investments. And also, as we said a few times, the six businesses within Global Banking and Markets, which represented the big investment spend, are starting to actually return.

Trading conditions for us actually showed some improvement in October, but the outlook for the global economy remains challenging. However, we honestly believe that faster growing markets clearly offer significant growth potential and attractive business opportunities for HSBC. And we believe that China will make a soft landing, not a hard landing.

So we're pleased with the progress on our strategy, but we recognize that this is a long journey, but we are determined to deliver on our goals by 2013.

Thank you all for your interest in HSBC.