HSBC

2012 Interim Management Statement

Presentation to Investors and Analysts

Edited transcript

5 November 2012, 11.00 am GMT

Operator

Good morning, ladies and gentlemen, and welcome to the investors' and analysts' conference call for HSBC Holding plc's Interim Management Statement. For your information, this conference is being recorded.

At this time I will hand the call over to your host, Mr. Stuart Gulliver, Group Chief Executive.

Stuart Gulliver, Group Chief Executive

Thanks very much. Good morning. Iain Mackay is with me today, and, first of all, we'll give you a quick overview and then we'll take your questions.

Our strategy and our business model have enabled us to have a strong quarter. Although reported PBT for the quarter was down $3.7 billion compared with the third quarter of 2011, the underlying profit was up $2.8 billion to $5 billion, and it's obviously on an underlying basis that we measure our performance.

For the year to date our underlying profit was up $2.6 billion to $14.9 billion.

For both the quarter and the year to date, our increased profits were driven by revenue growth in Global Banking and Markets and in Commercial Banking, and a significant reduction in loan impairment charges, notably in North America.

The third quarter results include an additional provision of $800 million in relation to the ongoing US anti-money laundering, Bank Secrecy Act and Office of Foreign Asset Control investigations. So we're actively engaged in discussions with the authorities to try to reach a resolution, but there is not yet an agreement.

The US authorities have substantial discretion in deciding exactly how to resolve this matter, and, indeed, the final amount of the financial penalties could be higher, possibly significantly higher, than the amount accrued.

Further background on the investigations is set out in today's IMS and the July interim report. And, as this is an ongoing legal process, this is all we can say on this issue at this time. We will not be able to take questions.

We also made additional UK customer redress provisions of $353 million, mainly in respect of payment protection insurance.

Underlying operating expenses for the third quarter of '12 was 16% higher than the third quarter of '11, primarily reflecting the impact of notable items, increased investment in regulatory and compliance infrastructure and higher litigation costs.

Excluding these factors, operating costs were marginally higher than the third quarter of '11, reflecting additional expenses associated with the execution of our strategy.

On an underlying basis our cost-efficiency ratio improved from 65.8% to 63.7%, due to revenue growth and strict cost control within our operations.

We have continued to make significant progress in delivering our strategy to simplify, restructure and grow HSBC. We've announced eight transactions since June 30, 2012, bringing the total to 24 this year and 41 since the start of 2011. We disposed of 57 branches in upstate New York in the quarter, completing our stated intention to dispose of 195 branches in New York this year.

And we've also reclassified $3.7 billion of customer loans and advances, net of impairment allowances, from our US consumer finance portfolios to assets held for sale.

In addition, we continue to see benefits from our organizational effectiveness program, achieving $0.5 billion of sustainable cost saves in 3Q '12, taking the total annualized savings achieved to $3.1 billion since the start of 2011. We expect to exceed the top end of our sustainable savings targets of $3.5 billion by the end of 2013.

And we also continued to grow the business in key areas; improved collaboration between Global Banking and Markets and Commercial Banking, resulted in an increase in associated revenues of 8% for the nine months.

And underlying revenues rose in the majority of our priority growth markets compared to the third quarter of '11; notably in the United States, in France, Argentina and Brazil.

Overall, we've had a strong quarter, driven by continued revenue growth, lower loan impairments and showing significant strategic progress.

Throughout our history HSBC has been where the growth is, and, with this strategy, we're ensuring that we maintain that distinctive position.

Now Iain will talk through the financial performance in greater detail. Iain?

Iain Mackay, Group Finance Director

Thanks, Stuart. You'll have seen the statement, so I'll just cover a few key points in detail.

Reported profit before tax for third quarter was $3.5 billion, down $3.7 billion on the third quarter of 2011, with $5.8 billion relating to adverse movements on the fair value of our own debt.

Reported profit before tax for the year to date was $16.2 billion, down $2.4 billion on the same period in 2011, of which $7.9 billion related to adverse movements on the fair value of our own debt. This was partially offset by $4.5 billion of gains on business disposals.

However, as Stuart said, we measure our performance against past results on an underlying basis, which excludes certain factors, including fair value movements on our own debt, which distort the period and period comparisons. Our IMS contains a reconciliation of reported results to underlying where relevant.

Underlying profit before tax was up $2.8 billion in the third quarter to $5 billion, and for the year to date was up $2.6 billion to $14.9 billion. This performance was driven by increased revenues and a reduction in loan impairment charges.

To achieve our cost-efficiency targets, we need both sustained revenue growth and strong cost controls.

The organizational effectiveness programme has delivered sustainable savings of $500 million in the third quarter, allowing us to invest for growth with only a marginal increase in our operational cost base.

The estimated return in equity, excluding the effect of fair value on own debt from the return, was around 11%.

Underlying revenue was $2.7 billion higher for the quarter and $4.2 billion higher for the year to date, compared with the same periods last year. Favorable movements on non-qualifying hedges accounted for $1.4 billion and $1.2 billion of these increases respectively.

Let's take a closer look at revenue growth, which was led in both periods by Global Banking and Markets. This was mainly from Rates and Credit, as credit spreads on both government and corporate bond portfolios tightened, liquidity increased and investor sentiment improved. This compares with a difficult trading environment in 2011; notably in the third quarter.

Commercial Banking revenue also increased, driven by net interest income, which reflected lending growth, as well as higher average deposit balances.

In Retail Banking and Wealth Management, revenues grew due to increased net interest income in Latin America and Hong Kong, and higher insurance revenues, mainly in Hong Kong. These factors were partially offset by the effect of the ongoing run-off of the US consumer finance portfolio.

Turning to loan impairment charges, we saw significant improvement in the quarter and year to date than the comparative periods last year.

The improvement in both periods arose primarily in North America, due to the continued decline in lending balances in our consumer finance portfolio, and improved delinquency rates, as well as the sale of the Cards and Retail Services business in May of this year. In addition, loan impairment charges in the third quarter of 2011 reflected higher costs to obtain and realize collateral as a result of delays in foreclosure activity.

Europe also saw an improvement in loan impairment charges and other credit risk provisions, reflecting lower credit risk provisions on available-for-sale asset-backed securities in both periods. There were also lower impairment charges in Retail Banking and Wealth Management in the UK, where delinquency rates improved in the nine months.

These factors were partly offset by higher loan impairment charges in Latin America, mainly in Brazil, following strong balance sheet growth in buoyant economic conditions in previous periods, which subsequently slowed.

Compared with the previous quarter, loan impairment charges were down, mainly due to lower lending balances in the Consumer Finance portfolio in North America, and in Europe from lower available-for-sale ABS impairment provisions, and significantly individually assessed impairments were not repeated.

In addition, we saw a marginal improvement in loan impairment charges in Latin America against the previous quarter, as measures to improve credit quality began to take effect.

Turning now to costs, underlying operating expenses, for both the third quarter and the year to date, were higher than the comparable periods of last year. However, in both cases, this includes the impact of several notable items.

In the third quarter, these included a provision of $800 million in relation to the ongoing US anti-money laundering, Bank Secrecy Act and Office of Foreign Asset Control investigations; UK customer redress provisions of $353 million, compared with $19 million in the third quarter last year; and restructuring costs of $97 million, compared with $195 million in the same quarter last year.

For the year to date notable items included a provision of $1.5 billion in relation to ongoing US anti-money laundering, Bank Secrecy Act and OFAC investigations; UK customer redress provisions of $1.7 billion, compared to $630 million in the prior year; restructuring costs of $660 million, compared with $672 million in the prior year; and the non-recurrence of both the UK pension credit of $587 million, and accelerated amortization of deferred compensation awards of $180 million.

Furthermore, we also increased investment in regulatory and compliance infrastructure in the US, and incurred additional litigation costs, notably in North America and in the rest of Asia Pacific.

Excluding these factors, the third quarter 2012 operating expenses were marginally higher than in the third quarter of last year, reflecting additional costs associated with the execution of our strategy, including transitional service agreements costs, which are offset in revenue.

On the same basis, year-to-date costs were broadly in line with the same period in 2011.

Looking at the last 18 months, operating costs have been in the range of $8.6 billion to $9.2 billion in each quarter. This run rate reflects strict cost control and the realization of sustainable cost savings through the implementation of our organizational effectiveness program.

These savings substantially offset ongoing investments in strategically growing the business and enhancing processes and technology capabilities, as well as inflationary pressures in certain of our Latin American and Asian markets.

Taking a look at the balance sheet, reported loans and advances to customers increased by $26.1 billion in the quarter. This includes favorable foreign exchange movements of $16 billion, which were partly offset by a $2.7 billion reduction in reverse repo balances.

Residential mortgage balances continued to grow strongly in the UK, Hong Kong and in the Rest of Asia Pacific. Higher demand for credit, and targeted lending activity focused on capturing international trade and capital flows, led to a rise in customer advances in Commercial Banking in Hong Kong and in the Rest of Asia-Pacific.

Lending to Commercial Banking and Global Banking and Markets customers in North America also increased, reflecting our strategic investment in target segments.

Customer account balances increased by $33.6 billion, including favorable foreign exchange differences of $18.8 billion.

Turning to the capital position, risk-weighted assets reduced by $5 billion in the quarter, due to a $10 billion decrease in market risk, mainly in Global Banking and Markets, which was offset by a $5 billion increase in credit risk. Credit risk risk-weighted assets increased by $8 billion, due to the weakening of the US dollar, with an underlying decrease of $3 billion as a result of a number of offsetting movements across the balance sheet.

We generated $3 billion of capital during the quarter. Combined with favorable foreign exchange movements of $2 billion, we've seen a total increase of $5 billion in core Tier 1 capital. The core Tier 1 capital ratio, therefore, strengthened to 11.7%, from 11.3% at June 30 of this year.

With that, let me hand it back to Stuart.

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Questions and Answers

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Stuart Gulliver

Thanks, Iain. So, now we'll take your questions. And, first of all, the operator will explain the procedure and introduce the first question.

Gary Greenwood, Shore Capital

I've got two questions, if I could. The first, just on impairment provisions in HSBC Finance Corporation, and I'm just looking on slide 6, and I note that the impairment allowance has dropped from $5.6 billion to $4.6 billion in the quarter. And I didn't quite understand why that happened. So that was the first question.

And then the second question was on the cost saving target, where you've upped your guidance to above $3.5 billion. And I think you previously said that you didn't want to push beyond that because you didn't want to damage the franchise. So I'm just trying to understand what's changed in terms of your view there.

Stuart Gulliver

Iain can take the first one and I'll answer the second.

Iain Mackay

I think there are two main factors around the impairment allowance change in HSBC Finance. One is, overall, the lower level of delinquencies that we're experiencing within that run-off portfolio, and that's probably the most important factor to note.

The second factor to note here is that, as you probably noted, we reclassified $3.7 billion worth of that portfolio into held for sale, as we market the non-real estate portion of that portfolio to secondary market buyers. And that is part of a broader program to accelerate the rundown of that portfolio.

So those are the main drivers within the impairment allowance.

Gary Greenwood

Sorry, just before you go onto the cost question then, just to pick you up on the delinquencies because the 2+ delinquencies have gone up from $8.3 billion to $8.4 billion in the quarter.

Iain Mackay

They have, but when you reflect on the trend and the overall delinquencies, and you think about the proportion that is reserveable, so although we've got the delinquencies that are increasing, a significant proportion of that relates to loans that have been in that delinquency bucket for a significant period of time and carry sufficient reserves against them. And then, overall, the trend within delinquencies has remained very, very stable.

Gary Greenwood

Okay.

Stuart Gulliver

On the costs, as I say, I'm guiding that we'll hit the top end, or slightly beyond the top end, of the $3.5 billion.

I think that we found, actually, that there's significant duplication of processes across a number of, frankly, subscale businesses. And, as we get our arms around Retail Banking Wealth Management, and our arms around CMB, and simplify to a smaller number of operating models, we've found some fairly rich opportunities to get costs out of the firm.

What we're not saying is that $3.5 billion becomes another number at this point in time. We'll reset that at the May 2013 Investor Day. But we are finding our ability to get costs out of HSBC, realizable costs, towards the upper end of that guidance.

Gary Greenwood

Okay. Thank you.

Chirantan Barua, Sanford Bernstein

I've two quick questions. The first one is on the UK SME book, and I assume that you've grown it more than 5% in a quarter. That's really punchy, because most of your competitors have come in saying there's no demand in the UK.

One, it will be great to get your feel for what kind of front book there and whether there's significant demand. Second, how sustainable is it? So that's the first question.

And then a second one is on Basel III.

Stuart Gulliver

So in terms of our SME book, yes, we've got 4% growth in a market that's shrunk 4%, so we clearly have taken market share.

Where it principally is, is we've focused on international businesses. So we've focused hugely on SMEs in the UK that are conducting international trade or, indeed, are involved in invoice, receivable financing with overseas operations, because obviously we're in 80 countries, or 79 outside the UK.

Almost by definition, that part of the UK market that's actually trading with other parts of the world where GDP growth is not negative, i.e., if they're trading beyond Europe but with the Middle East, with Asia-Pacific, with Latin America, those businesses are going to be more active, and probably more successful, than purely domestic-domestic. So there is a logic to this.

We're basically -- we set out this fund GBP4 billion to trade finance for SMEs; all of that demand was drawn down. We've now upped the fund to GBP5 billion.

So the segment that we've concentrated on does have growth; that's why we have growth. And I think that, provided that we see reasonable GDP next year in the emerging markets, 3%, 4%, which is a broad average we do, there's no reason why that can't be sustainable.

So what we've done is very much focused on where we have an advantage, which is trade finance, international trade, receivables; that type of stuff.

Chirantan Barua

And, sir, what about mortgages? There also you've grown it 5%.

Stuart Gulliver

We focused in there on growing our market share. The market share in mortgages has actually gone up a fair old chunk actually. If you go back to 2007, we had a drawdown market share of 2.6%; we're now at 11.6%.
But, again, we've tended to focus on, if you like, buyers with fairly low LTVs. The average LTV of a new business is 60% year to date, and the average book LTV is 52%.

But, again, we've got this advantage in the UK because we've got an A/D ratio, as you know, where we are deposit funded, and most of our competitors are wholesale funded. So we're deposit funded, we've got an A/D ratio that's under 100% in the UK. We therefore have an opportunity to take market share. And, actually, the UK business and the returns on UK mortgages are very, very attractive.

So we absolutely have used our funding position in the UK to take SMEs with an international focus and mortgages, but mortgages, essentially, where people are putting down 40% or so.

Having said that, we've done a chunk of first-time buyer mortgages where we've approved, actually, 33% increase, GBP4 billion, to first-time buyers this year versus last year.

So this is very deliberate, and it's taking advantage, effectively, of the superior funding position we have here.

Chirantan Barua

Thanks, sir, then. One question of Basel III for Iain, probably. You had guided to 110 basis points in mitigation take off in the fully loaded Basel III number, so what is progress around that?

And the other thing is, the $10 billion in market risk-weighted assets that you have taken off, so are you revising your Basel III guidance?

Iain Mackay

No, actually, we're not. I think broadly our experience, as we go through the mitigation impacts of Basel III and our ability to realize those, if anything we're growing them slightly.

But I would say the guidance around the impact of the implementation of Basel III on HSBC remains largely consistent with the guidance that we put out in May of last year, and reaffirmed earlier this year.

So really our experience is telling us that we can mitigate that effect and it remains largely, it's not identical, but it remains largely in line.

Chirantan Barua

Perfect. Thank you.

Chintan Joshi, Nomura

If I can just follow up before I ask a couple of questions. You're not willing to give an absolute number on the costs until May 2013. Could you at least give us some indication of the size of that, broadly, as in are we talking slightly higher or could be materially better by May 2013?

Stuart Gulliver

You mean the $2.5 billion to $3.5 billion, where we're going to reset it at?

Chintan Joshi

Yes.

Stuart Gulliver

I think you should assume that it would be slightly higher; not materially higher.

Chintan Joshi

Okay. Thank you. My question is around lending growth. If I look generally, I just think for FX it's about 5% annualized this quarter. Could you just give us some commentary around where do you see growth within various operations?

And then, just focusing on China, some of the Asian banks are highlighting an improvement in activity levels in China. Are you already seeing this in your operations? Thank you.

Stuart Gulliver

So lending growth and growth in the balance sheet, if you look around we've got strong growth in the UK and Hong Kong, and also in Singapore and Malaysia in residential mortgages. In Global Banking and Markets, the Commercial Banking tends to be Hong Kong, Rest of Asia-Pacific, China, and, actually, in Europe as well. So there's a fairly broad base, to be quite honest.

The only place that there isn't substantial growth is in Brazil, which is partly actually due to the fact that we deliberately changed the risk appetite in Brazil about 20 months ago.

There was a blip of increased lending in 2009, 2010, which resulted in elevated LICs and we, essentially, decided to change our risk appetite there, which resulted in slower loan growth. And, obviously, if you're looking in dollar terms, the Brazilian real's also weakened a chunk.

But it's pretty broad based. In China, our China business continues to grow quite satisfactorily, actually.

Chintan Joshi

Okay, so you are seeing an uptick then towards (multiple speakers) --

Stuart Gulliver

Yes, and also what absolutely is happening as well is in Global Banking and Markets, and this is also true of Commercial Banking, we can see a market share opportunity to take, from the fact that some of the Continental European banks have had to pull out. So in Asia-Pacific, particularly, the French and the Middle Eastern, the Germans, and, to some extent, Latin Americans, the Spanish, are not as aggressive as they were before.

And a lot of this is US dollar finance, so if you have a US dollar deposit base, which we do and obviously the American banks do and Standard Chartered does, we effectively can take that market share, and that's also happening. And that market share piece will take a couple or three years to work through. In other words, it's not a single binary event.

If you just think about the way large corporates work, they put up payments and cash management mandates every couple or three or four years for tender. So there's a whole process of retendering for transactions and so on that will take place.

And I think that that market share gain probably started mid '11, so it's probably got a couple more years to run effectively, just in terms of the practical aspects of the cycle of when large corporates or large insurance companies renew their sub-custodian mandates etc.

Chintan Joshi

Okay. Thank you. And finally, I saw some Bloomberg headlines on LIBOR; you made some comments earlier. Could you provide an update there, potentially when we can see the matter go past us?

Stuart Gulliver

Actually the only comments we made to Bloomberg was that we actually have nothing to report at this moment. I haven't had the chance of seeing how that was reported as a headline.

We're a panel bank for LIBOR and we're a panel bank for Euribor. So, clearly, we've been asked by a bunch of government authorities around the word to submit data to them, which we've done.

But that's as far as it's got at this moment in time, and, therefore, there is nothing fresh to report in this set of numbers.

Then on the legal case side, yes, we're part of a number of private class action law suits in the US, but they haven't progressed either at this moment in time.

So to be very, very honest with you, there is nothing really to report at this moment in time.

What I also did say to Bloomberg is, as of today, we have also not dismissed anyone, as a result of any LIBOR or Euribor investigation.

Chintan Joshi

Okay. It says a number of people have left on LIBOR on Bloomberg, but never mind. Thank you.

Stuart Gulliver

It's been corrected apparently because actually I said no-one had.

Chintan Joshi

All right. Thank you.

Alastair Ryan, UBS

On the margins, it looks like there's quarter-over-quarter growth in lending, stripping out currencies. So assuming that you've still got a drag from households, the volumes are now going up.

Just trying to work out whether the margin's more or less stopped going down because in the 20 basis points year-over-year decline in the quarter, there's obviously the Cards have come out of that and household (multiple speakers) down. So just whether there's more to come from the very flat dollar yield curve or whether you're pricing out the difference and the loan growth is now offsetting that.

So just the best sense of whether we've reached a level or there's still more to come on the margin compression.

Stuart Gulliver

As you rightly point out, the big drop in the margin is deliberate. We sold the Card business, and we're running down the household portfolio. So what was a very high net interest spread business also resulted in very high loan impairment charges.

So the contraction in the net interest spread is also shown up in the contraction in the loan impairment charge because we're de-risking and hoping for higher quality revenue, which is less volatile because there's less taken back through the loan impairment line, and, therefore, in theory, the profit before tax actually should be higher.

Some of that process is still running through. There's also a contraction from balance sheet management in the sense that, obviously, we've got incredibly flat yield curves, and although we've managed to, generally speaking, outperform the guidance we've given in BSM, the steady state operating number for BSM you should assume is the one I've always been saying, which is about $2.5 billion.

Now, we've punched above that because there's been points at which the yield curve in the naught to three-year period has been steepened by activities that central banks have taken. That, more or less, is dropping away now.

But in terms of how much further contraction has got before loan volume growth offsets it, there is some evidence of that taking place in Asia-Pacific, and I'll let Iain give you a bit of detail.

Iain Mackay

Yes, Alastair, if you dig into the NIM, certainly in North America you see the full impact of the disposals which Stuart referred to. But if you then go back up over the last three or four quarters, really across the UK business, across Hong Kong, Asia-Pacific as a whole, even the Middle East, Latin America, you're seeing very stable net interest margin to even a little bit of expansion.

And that expansion is really just based off opportunities, whether from a competitive perspective or from a cost-of-funds perspective, to price assets a little bit more aggressively. And, clearly, from a funding position we benefit on the spread side, but with a very heavy deposit funding base, with relatively low cost of funds there.

So although there's a little bit of compression at different points, overall it's balancing out across the piece quite nicely.

Alastair Ryan

Thank you. Very helpful.

Cormac Leech, Liberum

Just a couple of short questions, actually. So the first one was on the loan-loss provisions coming in at $1.7 billion for the quarter. That was quite a bit lower than what I was going for and consensus. I guess the question there would be, is this potentially likely to be sustainable going forward?

Iain Mackay

I think the main thing to focus in on there, Cormac, is the focus on running down the US book of business.

I'd mentioned a little bit earlier that we'd reclassified $3.7 billion worth of our CML run-off portfolio, specifically the non-real estate business, into held for sale. And that's part of a broader program to try and accelerate the rundown of that portfolio, which simply continues to be a significant influence on the overall loan impairment charge line for the business as a whole.

Looking across the rest of our key portfolios in the Group, we have stability, overall, from a credit perspective. I think something else to bear in mind is that we certainly had much lower impairments across the ABS portfolio this year than we'd experienced last year. And, when you dig into numbers, actually the available-for-sale reserve, which had been substantially negative in preceding periods, had actually gone slightly into credit this time for the first time in a number of years.

So I don't think we necessarily get a ton of movement across the ABS, but when you look at the underlying lending portfolios, there's a strong focus on moving towards secured de-risking the overall portfolio, and although that does have some adverse effect on spread, as Stuart had mentioned, we fully expect to see that come through in terms of stabler loan impairment charges.

Stuart Gulliver

And it's a very deliberate policy that we've got.

Cormac Leech

Right, okay. No, that's very helpful. And then the other quick question I had was on the total loans in the quarter seem to have gone up by about $10 billion when you strip out FX, which is really just about 1%, I guess, in the quarter.

Is that the kind of run-rate we should be thinking about in terms of overall constant FX loan growth going forward? Or should it potentially accelerate slightly as your capital position strengthens?

And the other quick question I had was, where do you see your fully-loaded Basel III as of right now? I think it was 9.2% at the end of June. Thanks.

Stuart Gulliver

I don't think that we particularly have a target to grow -- the way to think about the way we run the firm is, we don't set out saying, please go and lend $10 billion in the quarter. It is clearly going to be demand driven, and driven on our own credit policy. So, in a way, the logic as to how it grows comes the other way round. What we will therefore always make sure is that we continue to grow deposits.

You'll see again that our deposits grew quite satisfactorily in the quarter, and the A-D ratio is effectively more or less static as deposit growth was able to fund new lending growth.

So the way it logically works is, what we're absolutely obsessed with is taking deposits in. That then gives us effectively the raw material to fund lending. Lending's then demand driven. So it's not -- what we're not doing is saying to the RMs, go lend $10 billion per quarter, per quarter. So it's kind of an output.

Cormac Leech

Yes, understood. And on the Basel III fully-loaded, can you comment where that is right now?

Iain Mackay

As I mentioned earlier, the guidance remains highly consistent. I think it depends a little bit on some of the regulatory impetus around the speed to implement. But I think if we were to expect full implementation in 2013, we would certainly expect to see a core Tier 1 in excess of 10% with full implementation in '13.

And, as we move through to 2019, with more opportunity to fully realize the effect of mitigation, most notably further rundown of legacy portfolios in Global Banking and Markets in the US, then even more so.

So a little bit depends on when you expect to see full implementation. But, in either scenario, we see a fully-loaded ratio north of 10%.

Stuart Gulliver

And the important thing, Cormac, is that's coming from basically retained earnings. So we added $3 billion in this quarter alone to our capital base. And don't forget so far this year, we've paid $4.9 billion in dividends. So we're very capital generative.

So, as Iain says, even if it comes in that we've got to be Basel III 2019 basis at the end of '13, we're at the 10% and we'll get there through retained earnings, through capital generation ourselves.

Cormac Leech

Okay, understood. Thanks.

Rohith Chandra-Rajan, Barclays

A couple from me, please. One on strategy, and then also just going back to the US impairments.

Just in terms of Stuart's comments on one of the early questions, just to check my understanding on the costs. So you haven't really stepped back from the scale of reinvestment that you had previously indicated, but it's just that the run-rate of cost savings, or the ability to save costs, is better than you expected. Is that the right conclusion to draw from your earlier comments?

Stuart Gulliver

Yes. The way we think about it is, is we've run the firm now for several quarters with a range of between $8.6 billion to $9.2 billion a quarter of running-the-Bank costs. We've effectively within that realizing sustainable saves of $3 billion, which effectively we're reinvesting in executing the strategy, dealing with wage price inflation in the emerging markets, dealing with the fact that the cost of legal compliance, risk, etc., has gone up.

And what I'm saying is that we're finding costs to save which we can then reinvest in changing the shape of HSBC.

So we've got this program of disposals that's running through, we've got this program of headcount cuts that's running through, and, effectively, we're self-financing the change of the shape of the business is probably the best way of thinking about it.

Rohith Chandra-Rajan

Okay, thank you. And then just on the cross sell, CMB to GBM revenues which -- where the target was doubled, I guess, from $1 billion to $2 billion at the strategy day. Just wondering what the run rate is there. You talk about in the statement an 8%, I think, uplift year on year; just wondering what the run rate is.

Iain Mackay

Sorry, say the question again.

Stuart Gulliver

Where we're at on the GBM-CMB versus the $2 billion.

Iain Mackay

Well, if you recall, through the half year we increased the target that we'd set back in May of 2011 from $1 billion to $2 billion. In terms of the overall numbers, we're well ahead of $1 billion.

Rohith Chandra-Rajan

Okay, thank you.

Stuart Gulliver

We had to find sheet 3,012 there quickly. (laughter) We're above $1 billion, so we're making our way towards it.

Rohith Chandra-Rajan

Okay, that's great. Thank you. And then one final one, just on the US reclassification which had already been done, I guess, in the US-GAAP accounts. The US-GAAP accounts had also reclassified about the same amount of mortgages. Just wondering if we should read anything into that from a lack of reclassification of mortgages in the IFRS. Is that just a timing issue? Or if there is anything else to talk about there?

Iain Mackay

No, it's a timing issue. The treatment -- really it's just a question of the stage of progress with respect to some of the transactions that we had talked about at the half year, about trying to do disposals of some of the defaulted loan portfolios within the mortgage book. That's very much in process, but we've led with the non-real estate transactions, and we'll follow on with the defaulted loan portfolios in the early part of next year.

Rohith Chandra-Rajan

Okay. Thank you very much.

Raul Sinha, JPMorgan

I have two questions, please. Firstly, I was wondering if you can comment on the outlook for Rest of Asia-Pacific, and particularly the impairments.

There's a worry that the slowdown in China and the economies there will lead to a rise in impairments across the board, yet all I see in Q3 for you guys is a release in Singapore. Could you comment on what forward-looking trends indicate over there?

Iain Mackay

Forward-looking trends. You guys always like to learn a little bit more about what's going to happen in the future as opposed to what's happened in the past; I've got a strong preference for the same.

Again, I think overall we see reasonable stability. And, again, the purpose that Stuart had described around de-risking portfolios with a movement more towards secured lending, holds equally true in the Rest of Asia-Pacific as it does in the rest of the world.

I think what we've experienced, and we've experienced every quarter, is you get a little bit of lumpiness coming through some of the larger individual corporate exposures, whether it's in Global Banking and Markets, or Commercial Banking. We saw less of that this quarter than we had in the previous two quarters.

The broader portfolio, as it relates to mortgage lending and overall Retail Banking and Wealth Management lending, has remained remarkably stable.

And, although we do see some slowing within a number of the economies in Asia, they're still growing at fairly healthy rates; there's still expansion within those economies. There's a very eagle eye being cast across the portfolios, but stability, I think, is at least the outlook for the moment, based on what we know today.

Raul Sinha

And just to follow up, particularly on China-related sectors, or sectors that might be dependent upon export demand, is there any sign of a weakness in impairments so far?

Stuart Gulliver

There isn't. There isn't really any signs of individual loan impairment charges, or weakness, in particular clients. And that would also be true in India.

When you get to Global Banking, as you know, it kind of depends on which clients you've lent to, because it's not a broad collective loan impairment charge. And, with the client base that we have so far, there are no red flags that have gone up with our client base.

Raul Sinha

Thanks. The second area I just wanted to get your thoughts on, Stuart, was dividend growth, especially given the recent changes in the FSA's capital guidance.

I was wondering if you could comment anything at all on that. And I wondered if you might have been positively impacted by the shift towards absolute capital generation, which is actually quite strong for you.

Stuart Gulliver

Well, I think the thing about dividend growth is we remain committed to this policy of having a progressive dividend.

And we'll also remain committed to the ratio, in the broadest sense, that we outlined last year that we'll be looking for 50 -- of every 100 units post tax, we'd be looking to retain 50 units to build up the capital buffers for the firm, pay 35 units out in dividends to our shareholders. And then the bit that's left over, being round about 15 units, goes in compensation.

That would tend to be still the way we would want to approach it.

I would expect that this year, again, like last year, we'll have a detailed discussion with the FSA on distributions. And we'll need to get them comfortable that our capital generation, which obviously was $3 billion in the quarter, is strong and enables to get us to that distribution point.

But I don't think, at the moment, from what we see, that there's anything that's happened that changes our core thinking of, it's a progressive dividend; the payout ratio will be 40% to 60%. We'll tend to do this 50/35/15 type of split and that remains the case.

Raul Sinha

Great. Thanks very much.

Chris Manners, Morgan Stanley

Just two questions, if I may? The first one was on the revenue trajectory in the Rest of Asia-Pacific area, because, I guess you had some negative impact from the rupee and some disposals in there. But the revenue did seem to be down reasonably, considering that you had loan growth there.

So I was just trying to work out if there's anything else we should be looking for and how you see that trending over the next few quarters.

And the second one was on liquid asset buffers. I'm just trying to ask, have you had the chance to actually reduce the amount of liquidity you need to hold in the UK after the changes in the rules? And, if so, does that free up any more space for new lending or help the margin at all? Thank you.

Stuart Gulliver

The liquid asset buffer for us doesn't really make a great deal of difference. We've always been a firm that operates with considerable amounts of liquidity. And, if you like, we didn't have to increase our liquid assets when the regulations tightened and nor would we choose to run down our liquidity at this point at time.

I think the liquid asset buffer has impacted some of the other UK banks that were running with very little liquidity. It required them to hold substantial amounts and has now backed them off to a different position.

But the actual delta for us, both on the way up and the way down, is marginal. We're always going to operate with quite a big buffer.

Iain Mackay

And if we talk to Asia growth trends, I'll just give you a little bit of a quarter-over-quarter view in terms of movement.

Net interest income on an underlying basis is up 4% based on higher average lending balances in CMB and GBM, mostly in India, mainland China and Indonesia. And net fee income was pretty much flat. Trading income was slightly down. Overall, net operating income before loan impairment charges was up by almost 2%.

Looking at the movement Q3 vs. Q2, the decline in revenue is mainly driven by the Q2 gain from the sale of our interest in a company in the Philippines.

Chris Manners

Fantastic. So we should actually expect that to rebound because basically there's a one-off item in there?

Iain Mackay

Moves with the assumptions, Chris.

Chris Manners

(laughter) Yes. Thanks, guys.

Alistair Scarff, Bank of America

Just two quick questions. Firstly, on the recent property announcements in Hong Kong, given your strong run rate on a year to date, do you anticipate a material or meaningful slowdown in your pace of growth or your appetite for growth within that product segment in the territory?

Stuart Gulliver

I don't, actually. I think what we're probably seeing is a slowdown in secondary market transactions in the property market. But I don't think this is really going to substantially change the economic activity in Hong Kong.

What I think the Government's done is good, for the following reasons. You've got this almost bifurcation taking place in Hong Kong, where the economy has slowed to a 1%, 1.5% GDP and the property market's raged on ahead, as money's come into Hong Kong through QE.

And if you've got an ever-rising property market against a very weak economy and interest rates are where they are, you can see a situation where, if interest rates went up at some point, which clearly would depend on US raising rates, you could have a very bad property bubble bursting.

So, actually, in a way, I think this is actually good for risk management and good, actually, for all banks' financial positions, because it hopes to take the heat out of a market because you don't normally expect to have an economy at 1% to 2% GDP growth with a property market growing 25% in the first nine months of the year. You can see how that adds up to a little bit of a financial risk.

So I don't think it's negative overall. I think it's actually positive. because I think it puts away the likelihood of a kind of substantial sharp fall in property prices in later years.

And I think also the whole social equality issue in Hong Kong is quite important for society there and, therefore, reasonable GDP growth.

And I also think as well that China, once the 18th Party Congress is over, will have some form of fiscal stimulus come through, which also, in our view, will probably lift Hong Kong GDP next year back to 5%.

So, overall, I don't see this as a negative for our business in Hong Kong. I think these are quite welcome measures. Having, myself, dealt with Hong Kong for 32 years and lived there for 22, 23 years, these are sensible measures in a market otherwise that can do massive boom and bust moves.

Alistair Scarff

Great. And my second question's more looking at the nature of your lending in CMB and GBM over the recent, let's just say, 18 months to two years.

Have you materially increased your number of clients within that space? Or would you characterize your lending as a deeper wallet story?

Stuart Gulliver

Deeper wallet story. We've actually deliberately not tried to take on new credits. The view is very much here that if you start to take new credits, you don't know whether you're picking up an exciting new relationship or someone who's weak, is refinancing themselves away from a bank that's effectively pulled their lines.

So, with one or two exceptions, the majority, 85%, 90% of it, is deeper wallet with existing clients, who have been multi-banked, where one of their house banks has become weaker and, therefore, we've been able to pick up greater market share with someone we already know.

Alistair Scarff

Great. And a follow on for that, by default with the deeper of your wallet share of those particular credits, will the nature of some of these corporate and commercial delinquencies and defaults going forward, are they going to be incrementally more lumpy because of the, I guess, you could say, a slightly higher bid per credit? Would that be a fair call?

Stuart Gulliver

The correct way I would probably want to answer it is that we need to be very mindful in terms of our credit policy that our exposures will, and, therefore, our idiosyncratic risk, by definition, increases with the extent to which our exposure to individual credits increases.

But what I would hope to stress is that the policy we have on lending is incredibly conservative still. So you're right, from a theoretical point of view. But it's my job to make sure you're not right from a practical point of view. (laughter)

Alistair Scarff

Excellent, look forward to seeing that track out. Thanks a lot.

Tom Rayner, Exane BNP

A couple of questions, please. The first one, I think, at the half-year stage, you gave us some figures on your return on risk weighted, both underlying at 1.8% and then stripping out all of the legacy positions, which was a more attractive looking 2.3%.

Are you able to update those numbers at all for the third quarter?

And I have a second question on your tables on page 5 of the release.

Iain Mackay

I could give a simple yes to that answer, couldn't I?

Tom Rayner

Yes, you could and then you'll say, here you are, Tom, the number is X. (laughter)

Iain Mackay

But that's not the question you asked, Tom. Yes, I could do that. We're looking for precision here, okay? One second, let me --

Tom Rayner

Well, I'm trying to get a feel for how significant the legacy issues are; whether they're still the same sort of drag that you were seeing in the first half, I guess.

Iain Mackay

Well, on that point, it remains largely consistent, again, which informs, not insignificantly, the amount of focus that we're placing on trying to accelerate the rundown of the US portfolio. So the drag remains consistent.

When you look at underlying, excluding run-off and legacies, so that's excluding some of the old SICs and SIVs under Global Banking and Markets and the US CML portfolio, overall, from a Group perspective, you actually -- let me see, you actually improve the return on risk-weighted assets by about 20 basis points.

The drag effect from legacy credit in Global Banking and Markets at September 30 has deteriorated slightly. So, by that, I mean there's less drag coming from Global Banking and Markets, but that's reflected largely by the fact that we've seen significant recovery in some of the prices within that portfolio.

And then, from a CML perspective, again, there's some improvement, but the improvement, again, is largely orientated around the fact that we've got a declining portfolio and reduced loan impairment charges coming through.

Tom Rayner

Great. Thanks very much for that. And the second question, just on your underlying constant currency tables on page 5, and I was particularly looking at the revenue one, where you show nine-month-on-nine-month underlying revenue growth of 9%.

I'm just trying to get a feel for what the annualized quarterly path would look like in the last two or three quarters. And also, again, if taking out the run-off, the impact of the run-off book, rather than just the bits you've sold, whether that would make any difference to your answer.

Iain Mackay

Well, I think intuitively it would, because, clearly, we're seeing a rundown in those balances at a fairly consistent clip, with a view to accelerating it. And, as we run that down, clearly, the revenue that's thrown off by that portfolio goes with it. So by excluding CML, which we don't in the underlying, you would probably see that step up a little bit.

In terms of the quarter-over-quarter-over-quarter trend, I have to apologize; I do not have that in front of me.

Tom Rayner
Okay. But your sense is that there's no -- is there an improving trend or stable trend, would you have thought, on that revenue developments?

Stuart Gulliver

I'd say it's stable.

Iain Mackay

I think it's pretty stable. When you look across the individual markets from an underlying perspective, and, again, underlying excludes only foreign exchange, only the impact of acquisitions and dispositions and constant currency. So, from that standpoint, you look across third quarter, second quarter, it's about 11%, but it's pretty stable.

Tom Rayner

Okay. Nice, thanks very much.

Ronit Ghose, Citi

Just two sets of questions, please. One is on asset quality, maybe more for Iain, and one on strategy for Stuart.

On asset quality, first of all, the number at the first half was $40.7 billion for your stock of impaired loans. Can you give us the number for the third quarter, please, for the nine-month number?

Iain Mackay

Stock of impaired loans.

Ronit Ghose

It was $40.7 billion at the first half.

Iain Mackay

You know what, we'll get back -- I don't think I've got that somewhere in front of me. We're going to take a quick look through it and if we --

Ronit Ghose

Okay, I've got a couple of just some smaller asset quality related numbers as questions as well, numbers questions.

In the Finance Corporation release you mention that there's going to be a top up in the fourth quarter for your credit loan loss reserve, credit loss reserve, of about up to 10%. I was wondering if that will come through in the IFRS numbers as well in the Group. There's a reference to up to around a $400 million top up in the US?

Iain Mackay

No, that's a US-GAAP adjustment and it's driven by a regulatory change within the US.

Ronit Ghose

And that won't flow through into the IFRS numbers?

Iain Mackay

It does not flow through to IFRS.

Ronit Ghose

Okay, that's perfectly clear. Thank you. And the last question on credit losses is, you've mentioned the ABS. There were some, it looked like some net recoveries in the third quarter in GBM in Europe. Have you disclosed what the number is? It looks like it could be three-figure-type number.

Iain Mackay

It's $20 million to $30 million.

Ronit Ghose

$20 million to $30 million?

Iain Mackay

Yes.

Ronit Ghose

Okay, smaller than I thought. Thank you for that. That's great. And just a big-picture question, maybe both for Stuart and Iain. Stuart, you mentioned that obviously the market share story from the Western banks, particularly the European banks deleveraging, withdrawing, is a multi-year story.

I wonder if you're seeing any change in trend or competitive dynamic from the local Asian banks and does this vary by market? Are you seeing them becoming more aggressive and, if so, in any particular geographies or products?

Stuart Gulliver

I think there's definitely a more competitive issue with regional banks in Asia, but it varies in terms of what product suites. So, in areas like trade finance, which is really where the Europeans, particularly the French, were dominant, you need US dollar funding because 80% of world trade's in dollars and none of those regional Asian banks have large dollar deposit bases.

So where they will compete is in local currency, in Sing dollars, in ringgit and Thai baht, clearly the Chinese in renminbi and in Hong Kong dollars. But, actually, in the US dollar piece, it tends to be more the American international banks, ourselves and Stan Chart that can pick up market share because, as I say, most trade is actually in dollars, so you've got to have dollar funding.

So I wouldn't in any way underestimate the importance of the regional banks but they'll come through much more in local currency. So they're likely more to come in domestic-domestic SME, than in international trade. And they're likely to come in the large multinationals, again, providing local currency funding lines for working capital in the country.

So they are competitors, but they're competitors not in the trade space so much as in working capital.

Ronit Ghose

And do you see them, particularly in the credit and on balance sheet, so whether it's particularly in lending-type products or is it more in the local currency they're also competing in flow-based products as well?

Stuart Gulliver

Both, actually; but primarily more in balance sheet and on-balance sheet lending. So you can dig into some analysis around some of the recent big M&A deals that have taken place in Southeast Asia, and you'll see some of the local banks coming in for very large tickets, which they'll keep on balance sheet to fund various acquisitions.

Ronit Ghose

Great, thank you.

Iain Mackay

So Ronit, going back to your question, I'll give you a percentage number of impaired loans to gross loans and advances to customers for the Group. In percentage terms, at the end of the second quarter that was 4.1%.

For the Group, at the end of the third quarter that's 3.9%.

Ronit Ghose

Right. It's gone from 4.1% to 3.9%. Okay, brilliant.

Iain Mackay

Now a feature in that, again, is that we've reclassified the NRE book in North America into assets held for sale, which means it comes out of the gross loans and advances to customers category. So that is part of the impact.

Ronit Ghose

Okay, thanks.

Christopher Wheeler, Mediobanca

Just really a question on capital planning. We've obviously talked a lot about ring-fencing but now you've got Liikanen thrown into the pot, which I think may be preferable to you. We've also got Martin Taylor questioning the deal you sensibly struck, I think, in terms of the PLAC you have to keep worldwide.

And now we have the Leader of the Opposition saying that Vickers hasn't gone far enough and he will certainly, or his party, will break up the banks if they take power in 2015.

Against all that noise and, given you have a very strong capital position, but what are you doing in terms of how you're looking at the -- your UK business in the light of all of that?

Stuart Gulliver

The honest non-flippant answer is there isn't enough specificity at the moment around any of that for us to be doing anything other than having quite a large team of people conduct a series of analysis as to how we would fit the Bank within, frankly, the ICB and Vickers' work, because we're assuming that that's the first one that we would need to work towards is the UK regime.

And we're assuming that it will come to pass and we're assuming that we will need to create a ring-fenced and non-ring-fenced Bank. But I wouldn't -- and I'm not able to say to you today, X amount of capital will go into the ring-fenced bank. Its return on risk-weighted assets will be Y and its ROE will be Z, because we don't have the specificity.

What you just outlined is the challenge we face and yes, there's a ton of work that Iain's team and Marc Moses, our Chief Risk Officer's team are doing all the time. But until everything settles down into clear precision, at that point in time we'll have some idea of what it does to the overall shape of the Group.

But, as you point out, we are capital generative -- $3 billion within the quarter, 11.7% Core Tier 1 capital ratio -- so we're in a position to respond quite honestly whichever version of this comes up.

Christopher Wheeler

Okay, thanks very much. I know it's a difficult one.

Stuart Gulliver

No it is. You can't give a precise answer to this because there isn't precision around the whole thing.

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

Michael Helsby, Merrill Lynch

I've got two questions, if that's all right? Firstly on costs, I think, Iain, you pulled out that the Q-on-Q costs were just slightly higher at $9.1 billion ex notable items. If I go back to the first quarter of 2011, then that implies about a 4% growth rate when you adjust for savings.

The way you talk about it, Stuart, in terms of you're paying for your investments and inflation, is that 4% representative of how we should think about the future?

Stuart Gulliver

Yes, I think it is.

Michael Helsby

Okay.

Stuart Gulliver

I think it precisely is.

Michael Helsby

Good. And second question is on bad debt. Just a bit of clarification in the US. Iain, I think in the second quarter the reclassification in the US GAAP led to about a $1.6 billion charge in the US-GAAP accounts. Is there any impact in the P&L from the re-class in IFRS, or is that to be decided?

Iain Mackay

No, that will come through on the execution of the transaction, Michael.

Michael Helsby

Okay. And the fall in the quarter-on-quarter bad debt charge in the IFRS accounts, is that more to do with the re-class or is that more to do with the delinquencies? Or is it a bit --?

Iain Mackay

Part of the fall, is obviously that, on a reported basis, we disposed of the Cards business, for which we did pick up loan impairment charges in the second quarter, whereas we did not in the third. And the last element is the re-class.

Michael Helsby

Okay. Could you quantify how much the impairment charge would have been for the re-classed assets in Q2?

Iain Mackay

I don't have that at my fingertips. I can give you the impact of the disposition of the Cards business. That was about $380 million. And then our delinquency was fairly -- delinquency was, as somebody pointed out, was reasonably flat. And, as to the re-class, I don't have the exact number in front of me.

Michael Helsby

Okay. Maybe that's something Nick could pass on a bit later.

And then just finally on bad debt, I was interested in your comments about the outlook for bad debt going forwards, because if I add up Europe, Hong Kong, Rest of Asia and Middle East, then your Q3 bad debt charge was only about 25 basis points, and that's clearly a lot lower than what I think you would see as your long-run average.

So are you saying that the quality of your book is, from where we are today, is just different from where it's been historically? Has there been step change?

Stuart Gulliver

I think we're saying that absolutely over the last 20 months we have changed our credit policy and our credit risk appetite. Whether I would be as bold as to describe it as a step change we'll only know after the event, looking backwards.

But we absolutely have consciously moved away from unsecured consumer finance, unsecured SME-type of lending. And we're also very, very tight in terms of the big global banking clients that we bank.

As I said earlier, we've gained market share with multi-bank existing clients; not taken on new ones being refinanced out of weaker competitors.

So it's always very hard to give precision, given that we've got rather a large number of clients, but this is very deliberate. And, therefore, we would hope to see that there is a different type of book now than we've had in the past, particularly in the period after we bought household and rolled out consumer finance practices into Mexico and into India, which is now history.

Michael Helsby

Right. Okay, that's clear. Okay. Thank you.

Stuart Gulliver

Okay, that brings our call to an end. So, just to recap, it has been a strong quarter driven by continued revenue growth and lower loan impairments with costs marginally higher, excluding notable items.

Operator

Thank you, ladies and gentlemen. That concludes the HSBC Holdings plc interim management statement call. You may now disconnect.

