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Interim Management Statement 3Q 2013

Presentation to Investors and Analysts

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Corporate participants
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Iain Mackay, Group Finance Director

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Stuart Gulliver, Group Chief Executive

Thanks very much. Welcome, everyone. Iain Mackay is with me today; we're going to give you a quick overview, and then take questions.

Our reported profit before tax is $4.5 billion on the third quarter, up 30% on the same period in 2012. This includes adverse fair value movements on our own debt of $575 million, compared with adverse movement of $1.7 billion in the same period in 2012.

Our underlying profit was $5.1 billion, an increase of 10%. Now you may find it helpful to look at page 4 of the IMS where we set out the items we include in our reported and underlying numbers. Both figures do include notable items, including a charge of $428 million for UK customer redress and a charge of $158 million for restructuring.

Our revenue was stable in the third quarter, compared to 2012, which reflects a mixed global economic picture and set against the backdrop of our continuing implementation of global standards and ongoing regulatory uncertainty.

Our home markets at the UK and Hong Kong, where we have material market share which drives the performance of the Firm, contributed more than half of the Group's underlying profit before tax in the third quarter and year to date.

Hong Kong performed well, with good revenue growth in Retail Banking and Wealth Management, commercial banking and global banking markets. Hong Kong continues to benefit from its close economic relationship with mainland China.

In the UK, we saw revenue growth in global banking markets and in commercial banking, and also growth in our residential mortgage book.

We remain well positioned to capitalize on improving economic conditions in both these markets, where we expect GDP to be higher in 2014 than it is in 2013.

Global Banking and Markets performed resiliently, notwithstanding a challenging environment for this activity over recent months. This relative performance was good because we have a distinctive business model with broad international focus, emphasis on customer connectivity and balance sheet strength.

Our loan impairment charges were down on the same quarter in 2012, driven largely by a reduction in North America from the continued run-off of our US legacy portfolio.

The ongoing recovery of the US housing market and increased investor appetite may provide further opportunities to accelerate the run-off of our CML portfolio in the months to come.

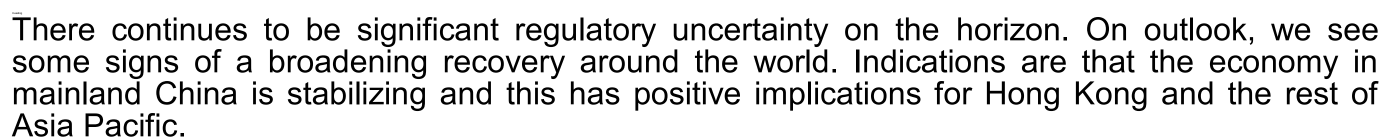
Our continued focus on cost management generated a further $400 million of sustainable cost savings in the third quarter of 2013, which helped us to reduce our underlying cost efficiency ratio to 57% from 62.5%.

For the year to date, reported profit was $18.6 billion, a 15% increase on the same period in 2012.

Underlying profit was $18.1 billion, a 34% increase on 2012. And we grew underlying revenue 9% faster than costs in the first nine months of the year, giving us 9% positive jaws.

We've also made further progress towards simplifying and restructuring HSBC, in particular through the recent completion of the sale of our Panama business in October.

Our capital position strengthened during the quarter with an improvement in the core Tier 1 ratio to 13.3%, and our estimated CRD IV end point basis common equity Tier 1 ratio also improved to 10.6% from 10.1%.



There continues to be significant regulatory uncertainty on the horizon. On outlook, we see some signs of a broadening recovery around the world. Indications are that the economy in mainland China is stabilizing and this has positive implications for Hong Kong and the rest of Asia Pacific.

We believe the US will continue to grow, albeit at a low rate by historical standards, as will the UK, which will outperform the Eurozone.

We expect GDP growth in Latin America to remain slow, although we expect the Mexican economy to strengthen in 2014.

Our forecasts for global growth remain constant at 2% in 2013 and 2.6% in 2014.

Against this backdrop, we remain focused on delivering organic growth, streamlining the businesses, implementing global standards and so supporting a progressive dividend.

Iain will now talk through the financial performance in some detail.

Iain Mackay, Group Finance Director

Thanks, Stuart. Stuart has outlined the overall results so I'll take a closer look at a few key points.

Reported profit before tax for the third quarter was $4.5 billion, up $1 billion on the third quarter of 2012, with $1.2 billion relating to lower adverse movements and the fair value of our own debt.

Reported profit before tax for the year to date was $18.6 billion, up $2.4 billion on the prior year period, with $3.3 billion relating to lower adverse movements on the fair value of our own debt, and $1.5 billion from the non-recurrence of provisions for fines and penalties recorded in 2012. This was partially offset by $3.2 billion in lower gains on business disposals.

Underlying profit before tax for the third quarter was $5.1 billion, up $500 million on the third quarter 2012. Underlying PBT for the year to date was $18.1 billion, up $4.6 billion on the prior year period.

I'll cover the key drivers behind this performance in more detail now.

Underlying revenue was broadly flat for the quarter, $1.1 billion higher for the year to date compared with the same period in 2012.

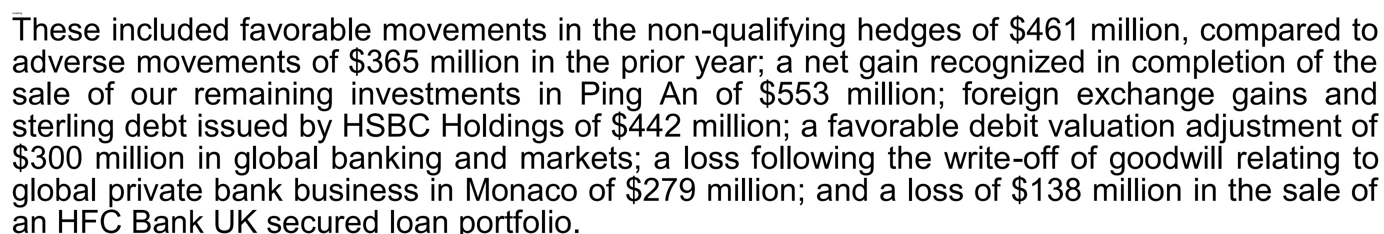
For the third quarter of 2013, underlying revenue was affected by an adverse debit valuation adjustment of $151 million in global banking and markets. Excluding this item, the revenue performance in the third quarter was as follows.

Global Banking and Markets produced a resilient performance with marginally higher revenues against the backdrop of the recent challenging environment. We grew revenues in commercial banking primarily from our home markets of Hong Kong and United Kingdom.

By contrast, revenue in Retail Banking and Wealth Management decreased, primarily due to continued runoff of our US CML portfolio and falling insurance revenues. These factors were partly offset by higher net interest income in Hong Kong.

Global Private Banking revenues also fell, reflecting lower net interest income.

Turning to year-to-date revenue performance, there were a number of items affecting underlying revenue.



These included favorable movements in the non-qualifying hedges of $461 million, compared to adverse movements of $365 million in the prior year; a net gain recognized in completion of the sale of our remaining investments in Ping An of $553 million; foreign exchange gains and sterling debt issued by HSBC Holdings of $442 million; a favorable debit valuation adjustment of $300 million in global banking and markets; a loss following the write-off of goodwill relating to global private bank business in Monaco of $279 million; and a loss of $138 million in the sale of an HFC Bank UK secured loan portfolio.

Excluding these items, the year-to-date revenue performance was as follows.

In Global Banking and Markets, revenue increased marginally with growth in the majority of our customer-facing businesses. Revenue increased notably from financing and equity capital markets, credit and equities, and this was partly offset by lower revenue in rates and balance sheet management.

Commercial Banking was also marginally higher. As with third quarter 2013, this was driven by performance in our home markets. Revenues decreased in Retail Banking and Wealth Management due to the US CML run-off portfolio, but revenue grew in the rest of retail banking wealth management, driven notably by a strong performance in Hong Kong.

Global Private Banking revenue decreased due to lower net interest income, as mentioned earlier, and an adverse impact for net new money as we continue to reposition the business' client base.

Turning to loan impairment charges, which were down $64 million in the quarter and $1.3 billion lower year to date on an underlying basis, firstly in the quarter North America was $400 million lower, primarily in our CML portfolio, reflecting an improved housing market, lower lending balances and reduced new impaired loans and lower delinquency levels.

This was partly offset by $100 million of higher charges in Europe, reflecting higher specific customer impairments in global banking and markets, and $100 million of higher impairment charges in Latin America, due primarily to specific exposures in Mexico and Brazil.

The increase in Mexico reflected a deterioration and a recoverability in exposures to home builder loans, and in Brazil it was across a small number of corporate exposures.

In the year to date, North America was $1.6 billion lower. Again, this was mainly driven by our CML portfolio rundown.

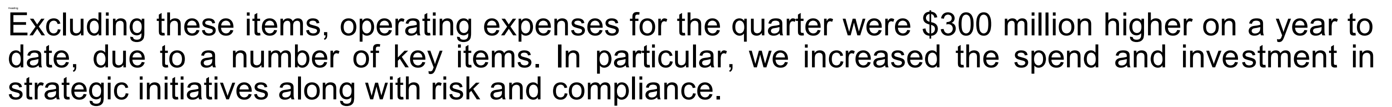
This was partly offset by Latin America where impairment charges were $400 million, principally due to higher specific and collective impairments in Mexico and impairment model changes for structured loan accounts and portfolios in Retail Banking and Wealth Management and business banking and commercial banking.

Looking at costs now, underlying operating expenses for both the third quarter and year to date were lower than the comparable period in 2012. However, in both cases this included the impact of several notable items.

In the third quarter these included UK customer redress provisions of $428 million, compared with $353 million in the third quarter of 2012, and restructuring costs of $158 million compared with $97 million in the same period last year.

For the year to date, notable items included UK customer redress provisions of $840 million, compared with $1.7 billion in the prior year, and restructuring costs of $396 million compared with $660 million in 2012.

You'll also note the non-recurrence of provisions for fines and penalties which were $800 million in the third quarter of last year and $1.5 billion for the year to date in 2012.


Excluding these items, operating expenses for the quarter were $300 million higher on a year to date, due to a number of key items. In particular, we increased the spend and investment in strategic initiatives along with risk and compliance.

Wage inflation was also a factor, and there was an increase in the provision in respect of regulatory investigations in our global private bank. These were partly offset by additional sustainable savings of $400 million. For the year to date, operating expenses were $600 million higher due to the following key factors.

Again, increased spend and investment in strategic initiatives, together with risk and compliance, and a provision in respect of regulatory investigations in Global Private Banking.

Additionally, there were higher litigation and regulatory-related costs, including a Thema International Fund PLC settlement which related to Madoff cases, and a customer remediation provision that related to our former US cards business. These were partly offset by additional sustainable saves of $1.2 billion.

Our underlying cost efficiency ratio improved 57% for the first nine months, compared to 62.5% in the prior year period. We clearly remain focused on strict cost control and driving sustainable cost savings through our organizational effectiveness programme.

I should also remind you that our year-to-date costs do not include the bank levy which we estimate to be around $900 million, and this is certainly worth taking into account as you update your cost estimates through the end of the year.

Turning to the capital position, our core Tier 1 capital ratio strengthened to 13.3% from 12.7% at the half year. This was principally driven by capital generation and foreign exchange movements.

The estimated common equity Tier 1 ratio after plan management actions increased to 10.6% from 10.1% at the half year. As Stuart mentioned earlier, our capital position continues to be influenced by ongoing regulatory uncertainty.

Now let me hand it back to Stuart.

Stuart Gulliver, Group Chief Executive

Thanks, Iain. We'll now take your questions. The operator will explain the procedure and then introduce the first question.

Questions and Answers

Chintan Joshi, Nomura

My first question is around capital, and the second around costs. On capital, we've had quite a bit of discussion around the CRD IV consultation paper. Some of your peers have guided us to higher minimum requirements. RBS said 12%, another bank informally has been guiding 11.5% and that's led to speculation on what minimum ratios might be for UK banks. Can I have your view on that topic?

And then I've got another one on cost.

Iain Mackay: Chintan, thanks. On the capital front, I think the situation with respect to a clear understanding of the framework, going forward, remains as unclear as it did when CP5/13 came out. There are still a lot of moving parts in this equation, as I think probably everybody on this telephone call knows. We set our guidance around common equity Tier 1 ratio end point at above 10% back in May. We certainly think above 10% continues to be relevant.

But I think what the third quarter demonstrates that, as we work through some of the implementation items coming out of CRD IV, lots of pluses and minuses that tend to net out. And, therefore, what you saw happen in Basel 2.5 ratio, and the Basel III ratio, generally reflected performance of the business, so capital generation, and foreign exchange movements.

There's more ground to be covered, but I think what we clearly demonstrated is the ability to generate capital. I think, from a dividend prospect perspective, clearly we continue to be very confident in our ability to support a progressive dividend, based on the three key strategic priorities that we've got. And as we learn more about the capital framework, we'll certainly inform the marketplace.

I think it's entirely possible that, as the UK implements CRD IV, that we may get guided to a higher point. But I think, at this stage in the game, there's simply far too much uncertainty to conclude us to where that might be.

Chintan Joshi: Okay, thank you. And on costs, if I look at consensus, it's got flat costs. You're on your way into 2014. Obviously, I'm not expecting you to comment on consensus, but would you be able to offset wage inflation next year if you saw revenue environment at a sluggish pace?

Stuart Gulliver: No, I don't think so. I think you have to accept the fact that there's probably a 2% type of cost increase which there has been for the last three years. So no, I don't think you can assume that we can offset in the sluggish revenue environment, the actual cost to run the Firm.

Iain Mackay: As we talked about back in May, we've got a sustainable saves target for 2014, 2015, 2016, and we've got a lot of work to continue to do in the organizational effectiveness. But those inflationary pressures come through virtually every market in which we operate around the world.

Chirantan Barua, Sanford Bernstein

I have a question on the UK, and two on Hong Kong, please. The first on the UK; Stuart, you mentioned that the outlook for next year looks very positive, so would you be willing to put on risk, and grow book faster than the market, as you've done in the last two years? Or are you stepping down? So that's on the UK.

And two questions on Hong Kong; again you're positive on the Hong Kong, but monthly home sales now are at 2008 levels. So do you see it flattish for the next half before it picks up? And other thing on risk-weighted assets, I see a sharp migration upwards from quality. It would be great if you can explain what that risk-weighted asset impact is coming from.

Stuart Gulliver: Sure. Looking at the UK, as you can see, as you were saying, we have actually taken market share over the last couple of years, both in mortgages, and also in the kind of international tranche of the commercial banking business. Now actually, the rate at which we can take market share in the UK has declined most recently, because of the Funding for Lending Scheme.

So what the other banks have done is drawn down the Funding for Lending Scheme and actually, rather than use it to actually fund SMEs, they've used it to drive back into the mortgage market. So the Funding for Lending Scheme has somewhat skewed the landscape and also somewhat depressed returns.

So what I would actually say is, yes, we will continue to grow risk in the UK. But our ability to actually, materially, drive into that is somewhat constrained by the fact that the weaker UK banks, i.e., those that are owned by the State, have been able to take advantage of the Funding for Lending Scheme. But, yes, I would expect to be taking additional risk;

So the harder piece, as I say, to get further growth is actually Retail Banking and Wealth Management, because of the impact of the mortgage market. But in commercial banking it's not, because we have a unique geographic footprint. We're in 80 countries outside of the UK. No-one else has that geographical reach. And as UK companies looking to trade with the rest of the world build up, we should be able to take a material share in that.

The third thing I think you can start to see is that in debt capital markets and foreign exchange, and actually increasingly now also equity capital markets, and it's always been the case in lending, we're very much closing the gap, or have closed the gap on Barcap. So there is also, not in the pure investment banking, we don't have a big derivatives' business, but actually in traded liquid markets, if you look at market share in things like DCM and in foreign exchange and lending, there's a gap closed there. So yes, we will be putting on risk in the UK, but you just need to be mindful of the fact that the landscape isn't quite as black and white as it was.

On Hong Kong, yes, monthly home sales, because of the various activities, or actions, that the Government have taken, are down at 2008 levels. And that has had an impact, clearly, on volumes going through, although, actually, margins have crept up a little. I don't think that this will get a great deal worse from here. So I actually think that the mortgage marketplace in Hong Kong is, more or less, at the kind of volumes that we're going to see.

Because you probably saw that a number of developers have started to discount in order to effectively get inventory starting to move. And there is still evidence of those big developers still essentially looking at new land bank and starting to discount, move inventory off their books. So I don't think that Hong Kong steps down again from the contraction that we've seen as a result of Government activities.

And I'm going to pass the RWA question to Iain, who's got an instant answer.

Iain Mackay: On the book quality front, maybe it's the way you're reading the chart, did you say that you saw a decline in book quality? Because I see exactly the opposite.

Stuart Gulliver: RWAs are going down because the book quality is improving.

Iain Mackay: And the main drivers for that is there's really increased exposure to better credit quality within the European business, largely in institutional and the corporate space. That contributes certainly the lion's share. Notwithstanding the shenanigans in the US around default, there was actually an upgrade of US sovereign risk in the quarter, which reflected the other most significant part of the decrease.

And then, overall, we saw that somewhat offset by a downgrade of the Hong Kong sovereign risk. But in the round, we saw credit quality improvements coming through the book, driven mostly by the European books of business.

Chirantan Barua: Iain, I was referring to the Hong Kong bit. Okay, so that was from the sovereign downgrade?

Iain Mackay: Yes, it was. That's right.

Chirantan Barua: Okay, perfect. It's only Hong Kong bit that I was -- okay, thank you.

Stuart Gulliver: Don't forget the UK regulator looks at non-EEA sovereign, so a 45% LGD.

Raul Sinha, JPMorgan

If I can have two quickly, please, as well? Firstly, if I can invite you to comment a little bit on your outlook statement. It seems uncharacteristically positive, especially around trade finance and transaction banking. Should we start to expect a pickup in volumes, and maybe even revenue growth, in rest of Asia, which has been sluggish for you this year? And then I've got a second one on RWAs.

Stuart Gulliver: I don't think you can necessarily take the comments about a broad recovery as being specific on trade finance. What you have seen, and what we have seen, is volumes pick up in trade finance, but margins actually still remain depressed on one year ago. So margins, in trade finance, are about 30, 33 basis points, lower, but volumes are double-digit up, sort of 20-plus-% up.

Now whether there's a turn in margins, I think is too soon to call, actually. But volumes, yes, we are seeing growth in volumes. And actually the anecdotal evidence that would kind of support that, that Maersk, the shipping company, also made a comment in the FT a little while back saying, calling, the bottom of the trade cycle. But there's no evidence yet of margins coming through.

We're optimistic that China will have a soft landing. We were of this view at the half year where if you recall, obviously, because there was a kind of sharp sell-off in the emerging markets, people were of the view that China was going to have a hard landing and the whole yen story was turning over, actually what we've seen in the meantime, obviously, is China probably accelerate reform. And it'll be interesting to see what the Third Pparty Plenum, starting on November 9, shows in terms of fiscal and financial market reform.

But China's probably going to have 7.8% GDP growth for this year. We think 7.4% for next year. That supports the rest of Asia Pacific. I think Japanese QE also supports Asia Pacific, because it tends to finance the Japanese supply chain. So that also will support Malaysia, the Philippines, Thailand, countries such as that. And so Asia Pacific looks reasonably good.

The Middle East actually remains strong, apart from obviously the political risk around Egypt, which again hasn't really manifested itself in a particular economic slowdown. So if you look across to Latin America, yes, Brazil is reasonably weak, but we didn't see a significant deterioration in credit quality there. There was, obviously, a change to book in the second quarter, some small specifics in the third quarter. And then most of the rest of the LICs in Mexico was the home builders within Mexico and the home builders.

If you come across to India, and again going back to Brazil, we don't have exposure to the big, idiosyncratic, global banking credits that are the ones that people are particularly concerned about. Now that doesn't mean that, if I'm wrong, and actually the outlook deteriorates, there may not be a worsening of credit into the names we are exposed to. But we do see a pickup in economic activity.

If China is 7.5% GDP growth, rest of Asia Pacific's fine. If the US is coming along at the rates we think it is, that supports the US and Canada. Actually, the UK is emerging with quite strong GDP growth, and between Hong Kong and the UK, that's over 50% of HSBC's PBT sitting in countries where GDP growth will be higher 2014 than 2013. So whether it's uncharacteristic, I think the outlook is broadly constructive.

Raul Sinha: That's really helpful, thanks. Maybe the second one, probably for Iain actually, on market RWA. On page 16, you show $8.7 billion decline in the quarter, down to movement in risk levels. I was just wondering if this is seasonal, or does it reflect derisking in Q3? Or should we expect this to be a permanent step down in your market RWA, going forward?

Iain Mackay: No, it's really just an expression of changing positions and construct within the trading book. I think you're going to see seasonalities throughout the global banking and markets' business. You see that first half stronger, second half a little bit of respositioning. And that's really what you see going on both within market risk and also the counterparty credit risk within global banking and markets. So I wouldn't read any more into it in terms of some repositioning and seasonality.

Raul Sinha: Okay, great. Thanks very much.

Ronit Ghose, Citi

Just a couple of questions on these product areas, on the global -- what a lot of other banks call transaction services or transaction banking, so your PCM business, security services, if I put them altogether you look like you're running up year on year 7%/8%. And I know you don't want to make a big deal of pickup in trade finance, but compared to peers like JPMorgan or Standard Chartered, you've been doing a lot better this year. What do you attribute this? Is this basically market share gain; is it volumes; why are you doing better in the whole trade and cash area than the peers? That's my first question.

The second question is more specific on Q3; foreign exchange had quite a sharp downturn after a couple of very good quarters. If you can give any more color, is that on the institutional side, or is it also on the corporate side that you've seen a slowdown?

And my final question is on the US CCAR process; you're going to be involved in that. Is there anything surprising that's come out from what you heard on Friday about the CCAR process versus your expectations? Thank you.

Stuart Gulliver: Okay, let's start with foreign exchange. So foreign exchange is primarily because we had an extremely strong second quarter and it contained actually very strong revenues in FX options. And in the third quarter, although there was, obviously, some reasonably big moves in emerging markets, actually vols generally fell. The dollar/yen vol fell from something like 17.9 to about 10.5 or thereabouts second to third quarter.

So actually, what we had was exceptional FX option revenues in the second quarter, which then normalized in the third quarter. So in a way you could look at it as, bearing in mind this a big corporate client book, that a lot of corporate hedging went through in the second quarter, which once it was done wasn't repeated in the third quarter. And the reason you can kind of see that is if you look at year-to-date FX revenues 3Q, 2012 versus 3Q, 2013, 3Q, 2013 was only about 5% below 3Q, 2012.

So actually, year to date, it's tracking the same as last year, the second quarter/third quarter effect in 2013 is more that we had an exceptionally strong second quarter and the third quarter normalized. And actually, October would indicate that it's moving back to the way the first half was rather than -- not the second quarter, but the first half in total was in terms of monthly contribution running through in October.

On the trade finance piece, we've focused hugely on this throughout the financial crisis because, throughout the financial crisis, we found that a large number of European banks pulled out of these type of business, particularly in Asia Pacific and the Middle East. And in essence, we were able to both take market share with local clients, but also with the very multinational corporations, be able to offer them payments in cash management in 60/70 countries. If you think about it, there's probably only two or three banks now that have the global network to be able to do this.

And in fact if you put it in another way, no-one would ever again be able to create from scratch an HSBC or Citibank or Standard Charter for that manner, i.e., someone in 80/100 countries, because actually the regulatory environment would never do that. So therefore, there's a limited number of banks sharing that wallet and, therefore, in a way, there's better pricing power than there was five or six years ago.

So I can't comment on how anyone specifically has done other than ourselves, but this is a very deliberate push that we've made. We've made it both in global banking markets and in commercial banking, and we've also got much closer collaboration now running between global banking markets and commercial banking, really from 2011 onwards, than we had before.

So the commercial banking piece gets access to, apparently, a more sophisticated product suite, and a more sophisticated product suite gets access to a client base that, historically, was probably doing its business with our competition. So it's a combination of collaboration, deliberate positioning and then I think quite significant advantages.

If you look at it from the advantage point of view and look at trade finance, trade finance is in dollars; there is now no interbank lending market. So unless you've got a dollar deposit base -- well, put it differently, if you've got a dollar deposit base you have a huge competitive advantage in pricing trade finance because you have to go and borrow the dollars from someone else. You're probably now doing it on a repo basis because there really isn't a clean interbank lending market anymore because, post LTRO, no banks got any unencumbered assets.

And if you look at the way Cyprus went down, if you lend to a bank as another bank, you're absolutely at the end of the creditor waterfall. So our deposit base, $1.3 trillion of deposits, same thing applies for Standard Chartered, same thing applies for Citibank, gives us a really big pricing advantage in trade finance.

Iain Mackay: CCAR, really nothing new coming out of this for us. We've now known for over one year that we were going to be one of the CCAR banks. We will, like the other major US banks be required to submit our capital plans on January 6, next year. This is the first time that we will be submitting under the CCAR, which as I'm sure you're aware is a fairly intensive analysis and stress testing of the capital management and planning processes.

In the US, we prepare that at HNAH , so that's the US consolidated entities level. And then within that the HBUS, which is our US bank, is subject to specific stress testing with the OCC. But look, we've got strong capital resources at a US consolidated and at a US bank level and we're working through the final phases of implementation.

As you've probably noticed as the other large US banks have implemented, they've usually received some fairly active feedback from the Fed on how they might improve their processes, and we continue to be engaged very actively with the Fed as we work through to implementation to ensure that we do absolutely the best we can in meeting those requirements.

Ronit Ghose: Great, thank you. Can I just have very quick follow-on? Stuart, you said that October for FX was a similar run rate for the first half; can I be cheeky and ask if that's true for global markets overall?

Stuart Gulliver: I think if you took the nine months, first nine months, divided by nine, October is about there.

Alastair Ryan, Bank of America

I'm just trying to do the volume times margin thing and then a supplementary on the share buyback. The commentary on margin is suitably HSBC, in a way; it's gone down, but there's something better and something worse. It feels like you've got balance sheet management in a very conservative place at present, so there shouldn't be a lot further downside to the revenues there; is that an assumption?

And second, if your outlook is more positive, as you highlighted, is it reasonable to assume that that translates into more than marginal volume growth, which is the commentary for the third quarter? So just trying to work through the general direction of those; I know there's a lot of moving parts.

And then on the buyback, would we have expected you to comment on that in this statement if there hadn't been any change? I suppose that's just a semantics point, but clearly, feeding back to the capital discussion, which is something that everyone finds very hard to calibrate, clearly not your fault but regulators have done this to us all. Thanks.

Stuart Gulliver: On balance sheet management, this year will be $2.75 billion to $3 billion; next year will be $2.5 billion to $3 billion. You're right, rates are at incredibly low levels; curves are steeper than they were. So BSM at one point remember we thought might be $2 billion/$2.5 billion, it's better than that because there's been steepness in the curves and also we've sold some positions and realized some gains. Because actually with rates at [350] year lows we think they're likely to go up, and that means at the short end, at some point in time, maybe a couple of years out, but fairly obviously so.

And then I'll let Iain comment on the rest.

Iain Mackay: If you look at it from a margin perspective, Alastair, why make it simple for all you guys, but we are large and complex. We've got a bit of moving parts going on, from a net interest margin perspective. Overall, nine months versus nine months as a Group level, excluding the impact of the disposition of the cards business in North America because that clearly had a very marked impact year over year because it was a high NIM business, we're down about 9 basis points overall, year over year for the Group.

If you track back the last two or three quarters we're sort of steady, stable as she goes, slight improvements at the same level of analysis, from a net interest margin perspective. Now when you look at what's driving that, we've got a little bit of margin improvement coming through the UK businesses; we're pretty much steady as she goes within Hong Kong.

And certainly also, as Stuart commented earlier, we saw some deterioration coming out of the second half, really out of -- well, in the second quarter around net interest margin. There's evidence to suggest, although it's probably pretty early, that we're seeing net interest margins stabilize within the Asian markets; North America, pretty steady, but it's been clearly impacted by the disposition of the cards business. Middle East, very steady as she goes; we've probably lost about 8 to 9 basis points across the year within the Middle East, and that's largely reflective with what you see going on in the Egyptian business.

And then in Latin America, we've actually been very steady to slight improvement, from a NIM perspective, but it's very slight; it's about 5 basis points. So overall, I would describe net interest margin coming through the third quarter as being fairly steady.

Alastair Ryan: Thank you. And then just on the outlook statement?

Stuart Gulliver: Yes, I don't think we would have commented. What we basically set out at the May Investor Day that we'll put through the AGM next year a resolution to be able to sterilize the scrip dividend, and nothing's changed in that regard. So in May next year, we'll put a resolution through the AGM and, hopefully, the shareholders will approve it.

Thereafter, we'll then need to decide on the circumstances that exist at that point, in terms of where the PRA and other regulatory regimes require our capital to be, combined with whatever the macroeconomic situation is at the time, combined with specific approval that we would need from the PRA before doing anything such as actually sterilizing the scrip.

So I don't think, even if there hadn't been a consulting paper set out and the RBS comments they made in their results, we wouldn't really have been commenting on the sterilization of the scrip. It's a process that we'll put in place, but the comment about when we activate it will depend on circumstances in the future.

What is quite clear, though, is our ability to maintain a progressive dividend is proven by the fact that, in this quarter, we had $2.6 billion of retained earnings after paying a dividend, which, together with some foreign exchange translations, enabled us to improve the CET1 CRD IV from 10.1% to 10.6%.

Rohith Chandra-Rajan, Barclays

I've got a couple actually; one on costs and coming back to capital and dividends as well. Just in terms of the quarter-on-quarter cost progression, once I take out the one-offs in terms of restructuring and also the conduct-related issues in the UK, it looks like underlying cost growth is something like 4% quarter on quarter. GBM looks very well controlled, with a pretty stable 51% cost/income ratio.

So the inflation seems to be in the non-GBM type businesses. I was wondering just if you could quantify the compliance spend in the quarter and how we think about that, going forward.

And then also, within the private bank, the cost of the regulatory investigations, are they meaningful? Are they one-off in the quarter, so really, just how to think about the cost progression from here?

Iain Mackay: Let me take the last item on private bank. This relates to the US Department of Justice and the Swiss Government debate over tax transparency for US persons having their accounts in Switzerland.

You'll have seen that agreements were reached between the Swiss and US Governments and exchange of information. You'll have a few other settlements by Swiss banks in the mix there and we're part of that investigative process.

And really just based on those intra-governmental agreements and some of the other settlements, we've made provision for where we think we might come out on that, but it's very early days in terms of how that proceeds. But I think we've take a fairly prudent position on that one.

When you talk more widely on the costs, we don't specifically go through what the incremental compliance cost is quarter over quarter. But clearly, what we have done, over the course of the last 2.5/3 years, is invest significantly in the process, the technology and the number of people and the expertise that we've got within that compliance base.

So the cost overall has certainly stepped up somewhere between $400 million to $500 million on an annual run-rate basis with respect to incremental compliance investment capability. And that is a step up in the cost base of the Firm. Now some of that, we have clearly funded through the sustainable saves that we are realizing within the organization. But that gives you a general guidance as to what we see going on within the compliance step up.

Now within that mix, we've obviously got the monitor that joined us at the end of July, we're going to have him with us for the next four to five years, certainly through until the end of December 2017. And he's got about 200 staff on board now; we expect him probably to have about a total of about 220. And that's going to, again, incur a fairly substantial operating cost for us over the next five years that clearly falls within that compliance bucket.

But I think, this particular quarter, and year over year, the main features within the cost base is the elimination of the fines and penalties that we accrued last year in the US, and basically halving the cost of UK redress, notwithstanding the fact that UK redress is a little bit higher in the third quarter than it was in the previous quarters this year.

Rohith Chandra-Rajan: Okay. Thanks very much of that, Iain. And then just coming back on the capital/dividend question; I guess Alastair asked about the buyback. Just in terms of when you put the capital generation together with the regulatory uncertainty, just how you're thinking about the dividend payout going into year end, relative to the 40% to 60% range that you targeted, and previous indications that the payout might be stepping up?

Iain Mackay: I'll use one word, which really bores you and irritates you, which is called, progressively. But what we see is strong profit generation coming out of the day-to-day operations of the Group.

We've paid three interim dividends of $0.10 apiece this year, which is up on $0.09 apiece each of last year. We'll reflect on the overall profitability for the year, and the capital position of the year, when we get to the time to discuss with the Board the fourth interim dividend.

But the view certainly is that we're demonstrating all the necessary capability to continue to progress that dividend through the fourth interim of this year and into next year.

Tom Rayner, Exane BNP Paribas

Could I have three questions, please? Just on the trade margin, Stuart, you mentioned the sort of trend on one year ago; could you just tell us what it's been in the last couple of quarters? Trying to get a feel for whether you've seen stabilization yet, I know that you might not see margins going up, but have they even stabilized? That's my first question.

Second, just looking at the US run-off P&L. The revenue in the third quarter seems to be quite high, relative to previous quarters, particularly when you adjust for the non-qualifying hedges. So I was wondering what's going on in the revenue there?

And just a final one. I've seen the text in your release on CRD IV, talking about you might not need as much mitigation on the material financial holdings, but also some concern over the RTS on own funds. Just wondered if you could update us on what those two issues mean for the ratio, going forward. Thanks.

Stuart Gulliver: So I'll do the trade, and then I'll pass the other two to Iain, wisely.

Actually, the trade margins haven't deteriorated, so if I look at -- actually there's a very, very modest further deterioration, if you look over the third quarter versus the second quarter, but I'm talking about maybe 4 basis points, whereas if you look 12 months on 12 months, it's about 30 basis points.

So there's a further small deterioration. So what you could probably say is, the rate of decline in the margin has slowed. But I don't think that we could honestly say it's bottomed out, and we certainly couldn't say it's going back up.

Tom Rayner: Okay. Very clear, thanks.

Iain Mackay: So, Tom, I think on your US revenues, what you're probably seeing is that, in previous quarters, we'd incurred not insignificant losses in the disposition of the non-real estate and defaulted loans within the US run-off portfolio. And in the third quarter that was a fairly clean business. Although we had certainly dispositions of defaulted loans, we'd basically done it at book value, so that we'd come out of those fairly clean, and, at the same time, releasing fairly significant amounts of capital and RWA from the disposition of those.

So as opposed to necessarily getting a ramp-up in revenues, it was more a factor of not having negative items in this period versus the preceding quarters.

That's on the revenue line. And then when you reflect just overall performance of that run-off portfolio, loan impairment charges coming down significantly, and continued work by Irene and Pat Burke and the team on the cost base, just continuing to progressively move that business

back to more of a break-even proposition for us, which clearly then helps the rest of the US business performance shine through a little bit more.

Iain Mackay: Yes, go ahead.

Tom Rayner: Well, I was just going to say, if Q3 is pretty reflective -- it looks like to me it's better than break-even. It's $100 million of profit in the quarter, and it sounds as if it's not too many distortions to that number?

Iain Mackay: I would say it's a fairly -- literally, when you look at the disposals that we did of defaulted mortgage paper in the quarter, they literally came out pretty much in the wash against book value. We've got a program that the team is working on, for really the first/second quarter of next year, which is again fairly substantial dispositions of defaulted paper. And the pricing on that, at the moment, looks fairly attractive.

The big question again, really on this book, Tom, comes back to loan impairment charges. So provided the employment position in the US holds up and continues to improve marginally, I think that's going to then be reflected on housing values in the US. Taking those two factors together, it's going to help our loan impairment charge performance.

But the trends that we see in terms of impaired loans, new delinquencies, underlying property values, it all tends to be progressively positive. So to see break-even coming through this book is not beyond one's imagination, to be perfectly honest. And that would be, clearly, enormously encouraging for the team that's been working pretty hard at this for about five or six years now. Okay?

On the capital own funds implementing regulatory technical standards coming out of the EBA, there's one or two of them which are worded in a way, and the PRA is pretty tuned in to this, that in actual fact, if strictly applied as they seem to be drafted, would suggest a look-through to, if you like, cross-holdings in financial institutions which could have a fairly penal effect on deductions to capital.

It's really uncertainty around certain aspects of interpretation, or more so application, of those standards, as they continue to be consulted upon and then reviewed by the various national regulatory authorities, and get finalized. So really all we can say is, we just don't know how it's going to turn out at this point.

Tom Rayner: Any sense of materiality, if it turned out worst case?

Iain Mackay: It could be really quite material. But I think, again, the proposed standard is written in such a way that it beggars belief that that's actually how the EBA would intend (multiple speakers)

Stuart Gulliver: It would also be fair to say that, if it was interpreted in the most conservative way, the impact across all of the European banks would be colossal. This is not an HSBC-specific issue. So what Iain is not saying is [it's] material to us and no-one else. It's one of those, if you interpret it that way, then the European Banking System needs to raise trillions of capital.

Tom Rayner: I'm with you now. Okay, yes. Thanks a lot.

Stuart Gulliver: So what we expect, and this indeed is what the PRA expect is, that literal interpretation will not turn out to be the way that particular rule is meant to be interpreted.

Ian Gordon, Investec

Can I just have two quick follow-ups, please? Firstly, on costs; I know you've probably done it to death, but just in terms of the comment in the ninth bullet on page 3, could you give me a bit of color on the higher investment expenditure in Q3?

And then, within your comments on litigation, you referenced some reserving in relation to Private Banking, but unless I misheard, you're not referencing any reserving for any other litigation issues.

Then quick second question on revenues. Obviously, I'm encouraged by the improved balance sheet footings. Just on net interest margin, you've given us lots of color, but could you possibly give me just the unadjusted Q3 NIM number, please?

Iain Mackay: The unadjusted Q3 NIM number.

Ian Gordon: At the Group level.

Iain Mackay: 222 bps.

Ian Gordon: Okay. Thank you.

Iain Mackay: In terms of the investment numbers, Ian, again across growth, across compliance, across simplification of the business, quarter on quarter there's a fairly consistent step-up across each of those three categories, which runs the better part of a couple of hundred million dollars.

It varies quarter to quarter in terms of which specific areas are focused on, and tends to be driven by the stage of implementation of various projects within the Firm. So what we saw in the third quarter is not necessarily significantly ahead of what we've seen fairly consistently over the last few quarters, in terms of rhythm around investment.

Ian Gordon: Okay. Thank you.

Iain Mackay: Okay. Sorry, you had another question, Ian, what was that?

Ian Gordon: Just in terms of any reserving for litigation. You mentioned (multiple speakers)

Stuart Gulliver: Whether there's any litigation other than the private bank, there isn't.

Iain Mackay: The other thing that -- obviously, the news broke during the quarter was the decision in the US around the Jaffe case, which is an 11-year old SEC securities case that was actually started against Household before we acquired it.

There was a partial decision against us in that. Now that that decision has been made, we are now in a position to go ahead and appeal that decision. We would have been prevented from doing so up to the point of a decision. That's now been handed down, so we'll go ahead and appeal this case.

Counsel believes that we've got a very strong argument, both in terms of technical merits, from a procedural standpoint, as well as the actual factual merits of the case. So although we've got a small provision against this case, we do not intend to strengthen that provision simply because of the strength of the case we've got. So it'll appeal. As to when this case will ultimately be resolved, knowing the US court system your guess is probably as good as mine.

Stuart Gulliver: Basically, all of this process is set out in note 24 to the –Interim Report 2013.

Ian Gordon: Yes.

Stuart Gulliver: Nothing's really changed. We set out what would happen in the event that the judgment that has been passed would be passed, so we just move to the next stage of it.

Iain Mackay: If you want a detailed update, it's in the HSBC Finance 10-Q for this quarter, where we've just updated around some of the facts of the legal decision.

Ian Gordon: Okay, that's very helpful. Thanks.

Alistair Scarff, Merrill Lynch

Just a quick one in terms of your capital, again. It's mainly to do with the FX movements that we've seen in recent times. Part of the capital increase, as you've attributed, was to FX movements. Under what scenario are you looking at there -- if we were to see a further strengthening of the dollar, for example, would that improvement that you're seeing in the capital position begin to unwind? How should we be thinking about FX within the context of your capital?

Iain Mackay: As you will probably have observed, if you track back over the quarters, Alistair, we've had foreign exchange impact coming through our capital ratios. It obviously impacts both the equity because we've got a net investment in subsidiaries around the world denominated in foreign currencies, as we have risk-weighted assets denominated in foreign currencies around the world.

We've seen, generally speaking, deteriorating impact from foreign exchange over the course of recent quarters. We are reasonably pleasantly surprised to see some strengthening from foreign exchange in the current quarter, mostly against sterling and the euro.

Obviously, other main capital exposures that we've got are either US dollar or US-pegged currencies. So the view of the euro and sterling against the US dollar goes then, so generally speaking, with our experience of volatility within our capital ratios coming from foreign exchange. You will have seen this coming through every quarter, to a greater or lesser extent.

Alistair Scarff: I have observed that, but if we were just to play this out further, I'm just trying to get some sense of how the Bank is positioning it. Is there any sense, in your mind at least, of how the Bank will try and ameliorate any issue in terms of, say, a dollar strengthening of significant magnitude, or conversely sterling increase of magnitude. Any thought on that?

Iain Mackay: Generally speaking, not even generally speaking, as a rule, we normally do not hedge our net investment in foreign currencies in our subsidiaries. We tend to protect ourselves from the foreign currency fluctuations by trying to match the balance sheet and currency and maturity within those balance sheets, on an asset and liability basis. Clearly, the net investment in that subsidiary represents a foreign currency exposure to us. That's just a foreign currency, if you like, volatility that we handle quarter to quarter.

John-Paul Crutchley, UBS

Most of them have been done. Just two quick ones, if I can? Firstly, Stuart, I just wonder if you could just mention the rates business in GBM, which contrary to the experience of most of your peers, appear to have a very good quarter. I just wondered if that was just a bounce back from weaker earlier in the year, or if there's anything we should be aware of behind that.

Secondly, I just wonder if you could just say a few words on the Private Banking business, where clearly there's been distortions through litigation charges redress, and indeed, it looks like a bit of business repositioning too, just to help us understand what's going on in that business. Thank you.

Stuart Gulliver: Sure. There are three things going on through Private Banking. Number one, there's a repositioning of the business, which has some impact on AUMs and revenues. Secondly, we wrote off the goodwill of the Monaco business at the point that we were reviewing whether to keep it or not. We subsequently decided to keep it, but we didn't write it back up. The third thing is the legal provision that Iain talked about, in respect of litigation that we face in respect of US citizens with accounts in Switzerland.

So there are three things running through it, two of which, if you like, are, one-offs is the wrong way to describe them but are exceptional items, the litigation provision and the treatment of goodwill. The repositioning of the business is, clearly, a go-forward impact. The three of them explain, basically, the material changes year on year, of which the provision the and the goodwill are by far and away the biggest impacts actually, not the revenue change.

John-Paul Crutchley: Right, okay.

Stuart Gulliver: Then the rates business, basically the significant improvement in the rates business, if you look at it year on year, it is still down, actually, versus last year. It's actually about $400 million down versus last year because last year had the enormous impact of the LTRO, which caused all credit spreads to tighten up, which, of course, didn't come through in 2013.

Quarter on quarter, you're right, it hasn't fallen as much as other people's have and that reflects, I think, really two things. One, that we have a substantial, if you like, high yield emerging market business, which okay, there was volatility in places like India and in Asia Pacific but, nevertheless, the DCM pipeline remained quite solid. Secondly, we've built up really quite a substantial European rates business, both in terms of sovereigns and super-nationals, where, again, the volumes remained really reasonably constant.

If you look at primary market league tables, you'll see that actually we've taken quite significant year-on-year gains in market share. Then the thing that really is absent, which explains probably why other people had a worse time, is we don't have a big US treasury platform. So we don't have US treasury, US munis, etc., so the impact on ‘are we tapering QE’, ‘what does that do to the US treasury market’, we get second order by US dollar denominated emerging market risk and euro govy curves and the gilt curve, not directly through the US treasury piece. So there's an absence of negatives as well as the presence of positives.

Mike Trippitt, Numis Securities

Two questions; one actually just follows on from what you said, Stuart. Just looking across the Asia Pacific and Hong Kong numbers, it feels like any concerns over EM worries in the third quarter, prospect of tapering, etc., you seem to have shrugged them off quite well. I just wondered is there anything in the country detail, particularly for Asia Pacific, that you would highlight or that we would see in the full-year numbers when they come through.

Stuart Gulliver: If you look across Asia Pacific, the two countries that have got the weakest macro are India and Indonesia. So undoubtedly, our Indian numbers will be down year on year, but actually, we don't, at this moment in time, have concerns about potential idiosyncratic large loan impairment charges.

Our Indian book was positioned quite conservatively a couple/three years ago, so we're not concerned that we have some exposure to the weaker Indian credits.

In Indonesia, again, the same would be true, that we're not particularly exposed to the weaker ones and so, therefore, to be honest, I don't think there is. Those are the two that I would pick out most of all.

If you look across India, we're down slightly. Indonesia, we're flat.

Australia's up, so, to be honest, not hugely -- in fact, if I just run through a list of countries that are up, 2012 versus 2013; Hong Kong's up, UK's up, Australia's up, Mainland China's up, Singapore's up, France is up, Saudi Arabia is, UAE is, USA is and Argentina is. So it's not across the board down at all.

And then the ones that are down are India, Indonesia, Malaysia, Taiwan, Vietnam, Turkey, Egypt, Canada, Brazil and Mexico. So it's quite broadly dispersed, so there isn't, within Asia Pacific, a particular thing that worries us.

Of course, the macroeconomics in these countries are quite different than 1997, 1998.

Mike Trippitt: Okay, great. Sorry, just a very quick follow-up. I'm encouraged by your comments on the acceleration or potential acceleration on the CML book. Presumably, that's just overall a house price improvement that's driving that?

Stuart Gulliver: Yes, it is. Basically, the improvement in house prices and then, essentially, liquidity coming back onto the investor side. Compared to this time last year, the book's $10 billion lower and, therefore, the book's $34 billion; it was $44 billion this time one year ago. We think that there's more that we can get out into next year.

I think that probably by 2016, or thereabouts, the book will probably reach an equilibrium level, unless there's a sharp deterioration in the property market, and that equilibrium level will probably be a book that's got a very high running yield that is current. And then we'll need to make a decision about whether we actually run it for yield or we sell that off as well.

So yes, it's all about two things, really. There are investors looking to buy these assets and these assets are starting to move up, so people are wanting to jump on the bandwagon. The point for us is, does this release risk-weighted assets at a loss which is greater in terms of capital creation than the loss itself, because these are 300%, 400% risk weighted.

So it's a very simple piece of math for us. So you've got this -- and most of the people buying these are not banks. So if we can release capital and generate more capital than we're writing down by taking a loss versus where we've got it marked, we'll do it.

Actually, what we've found is that most of these that we've managed to get rid of are really close to our marks, so there have been no incremental losses, which explains why when we were answering a question earlier about the profitability of the US, it is actually starting to get to a point where the US is running at a break-even or slightly positive level as we accelerate the book down.

Chris Wheeler, Mediobanca

Two quick questions. The first one really, I asked you I think, Stuart, in the summer whether you were 85%, 90% through the disposal process. I wonder if you would just confirm that still, because I think what I'm hearing is you may be revisiting certain businesses and just reviewing their place in the Group, asset management perhaps being one example where you may be looking to -- whether you want to be involved in that and on a day-to-day basis.

The second question, which I've asked most management of investment banks in the last three weeks, has been on the longer-term outlook in your view on tapering. The US banks rather said it was manageable. The Europeans have said, we're going to have to look at it closely. And then finally, Antony Jenkins said, fixed income revenues are going down, when he spoke on Thursday.

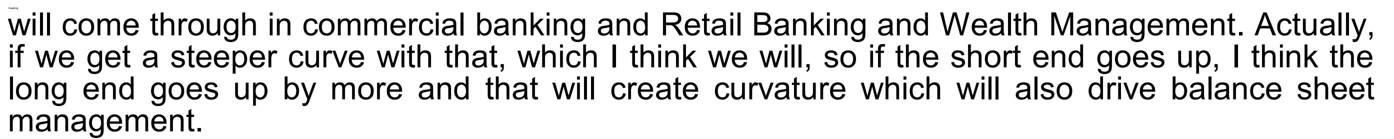
How are you thinking about that, particularly given that you have such a different footprint as you've shown in these results? Are you concerned about the outlook for the liquidity that's being sucked out of the market when tapering starts? Or again, do you think that you can comfortably manage it? Thank you.

Stuart Gulliver: Okay. So on disposals, we're still about 80% to 90% done and we're not selling asset management. So asset management's not going to be sold; it's not for sale; it's a key part of the wealth management proposition of the Group, both for retail banking and also for Private Banking.

On tapering, the impact for us on tapering is much more what it does to hot money flows that have gone into Asia Pacific and into Latin America and into the Middle East and Near East and I think they've all come out.

So I actually think what sat basically behind rather a rough reception to our half-year results reflects the market reacting to the removal of hot money, or whatever cliche we want to use to describe it, or money that's gone into equity markets and bond markets rather than into FDI coming out of various emerging markets.

Beyond that, the impact on us is actually on deposit rates, which is incredibly positive because, as rates go back up, clearly, we'll start to earn much more on the $1.3 trillion of deposits which


will come through in commercial banking and Retail Banking and Wealth Management. Actually, if we get a steeper curve with that, which I think we will, so if the short end goes up, I think the long end goes up by more and that will create curvature which will also drive balance sheet management.

So I think the removal of QE actually helps a bank that's deposit funded. Or put it another way round; the reason why interest rates went so low was to help banks that were interbank or wholesale funded because they generally were the ones that were incredibly weak and most threatened by the credit crisis, so rates were taken to zero to help them borrow cheaply to keep them solvent.

Those banks that have substantial deposit bases, like ourselves, lost $3 billion to $4 billion of net interest margin as deposit rates went to zero. So actually, the end of QE and tapering, I think is neutral for Global Banking and Markets because any impact on the fixed income market, I think the EM piece has gone through, but will be offset by probably positive BSM, for the Group overall, it's positive because of what we can drive off deposit rates.

Stuart Gulliver, Group Chief Executive

Thank you. Okay, thanks very much for everyone who's joined the call; very much appreciate your support for HSBC and your interest in us. Thank you.