Edited Transcript

Post-results meeting with Analysts hosted by Iain Mackay, Group Finance Director

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HSBC

Iain Mackay, Group Finance Director

Good morning. Given that we spoke only a couple of days ago, I don't really see much point in me introducing the results, since you've had a chance to read them. Why don't we preserve time for your Q&A and fire away?

Tom Rayner, Exane BNP

I'd just like to say I do like the disclosure and the efforts you're going through now to help us get a picture of the underlying trends. That's very helpful. I just want to get a sense of sustainability on a number of issues. I know you've been asked questions on the call on some of these but, looking at the revenue, could you just talk us through some of the issues, some of the AFS gains in balance sheet management and sustainability? I know you've given guidance, which would suggest some of that drops out. Also legacy GBM, how long would you see that being a drag?

When I look at costs, there's a very low absolute number but, once you get through all the currency effects and everything, it is 6% underlying growth and you're talking about further compliance and regulation, so again on the sustainability maybe of those jaws. Then impairments, again releases in Q1, are they going to be ongoing or were they very much specific, related to the fourth quarter.

Finally, loans: 2% growth in the first quarter on a clean basis, margins stable. Again, I think you said 2% NII on the conf call. If that is genuinely clean and that's what's happening, why wouldn't we just extrapolate that forward so we'd have a 7-8% growth in NII for the full year?

Iain Mackay

We'll try to take those in order, Tom. If you go to AFS gains, they're mostly coming through balance sheet management. If you track back over the last 8-12 quarters, there are quarters where that stands out but it is, in actual fact, part of what the team does from a balance sheet management perspective, in terms of looking at the composition of the portfolio. When the opportunity arises, they'll want to position the portfolio in line with the liquidity requirements that the group has and, at the same time, realise AFS perspective.

The fairest way to describe it is that the guidance on balance sheet management, of sitting between $2.6 and $2.9 billion for the year remains consistent. We did have a couple of cash flow hedges, which we cleared out in balance sheet management in the first quarter, which generated a gain of just over $100 million, which is an unusual item in that number, so that $100 million doesn't repeat. Beyond that, there is some variability in the degree to which we realise AFS gains as we reposition the BSM portfolio, from time to time.

Loan impairment charges in the first quarter. We, as perhaps we'd like you to expect, manage loan impairment charges based on the incurred losses that we experience, when we experience them. The nature of the geographical dispersion of the group, the nature of the diversification across Retail Banking, Global Banking and Markets, and Commercial Banking tends to result in some variability, quarter to quarter, both in terms of when provisions are made and when recoveries are made. If I go through the list of recoveries that we had in the first quarter, those primarily relate to reserve provisions that we took on Global Banking and Markets, or large corporates within Commercial Banking, over the course of the last two quarters of last year, as a consequence of renegotiating or restructuring those positions. Some recoveries against the initial provisions that were made have been realised.

They're lumpy. It's not something that we depend on quarter to quarter; far from it. We account for them as and when the events that support the provisions that we take and the restructuring of accounts indicate that the provisions have either been overly conservative, in the first instance, based on the information that we had at the time that was available. There's probably not a great deal more I can say on that.

One of you had asked on the call on Tuesday about how sustainable loan impairment costs, credit costs are. They are at a very low level. When you look at Europe, we had about a basis point of credit cost in the first quarter. Frankly, I don't believe, personally, that that's a sustainable position. I said at the outset

that I expected credit costs to be a little bit higher in 2015, and it certainly was our expectation, as we put together plans, that we'd have slightly higher credit costs for 2015, but certainly the first quarter surprised us somewhat in that regard.

Balance sheet, I think the numbers you've got are clean. You've done the calculation there. We've tried to provide as much information in the presentation. We tightened up that a little bit last year to make sure people could understand the impact of netting on the red ink balances and get a cleaner view, both of that as well as on a constant-currency basis. The numbers you're dealing with are clean numbers.

It is absolutely accurate to say that each of the global business leaders, and each of the CEOs in each of the subsidiaries, are under fairly consistent and constant pressure from Stuart and his team to grow the business – to grow the business in line with the risk appetite for the firm. As we've discussed in the past, that would tend to suggest low-to-middle-single-digit growth, and that's what we've accomplished in the first quarter, both on the balance sheet and from a net interest income perspective.

The principal turnaround on revenues in the first quarter was obviously a much stronger, but frankly a largely-as-expected, first quarter for Global Banking and Markets with, I hesitate to say this, some return to normalcy of the foreign exchange markets and our performance within those markets, which has historically been a very strong line of business for us. Relatively normal trading conditions in equities and credit, although I have to say the Asian equities business performed well in the first quarter. Some of that is almost certainly informed by the Shanghai-Hong Kong Stock Connect getting off the ground and volumes, certainly in the latter part of the quarter, beginning to step up. Rates was disappointing, but I've got a suspicion that rates is probably going to be disappointing for the foreseeable future.

In the Global Banking lines of business, they performed very much in line with what we've experienced over the last five or six quarters, which is slow, steady growth coming through payments and cash management, securities services and our capital financing businesses. Capital financing was a little bit slower in the first quarter than we'd hoped but, in the round, more or less in line with expectations.

Costs, your read on clean costs is certainly absolutely in line with ours. Underlying costs, on an adjusted basis, were up 6%. That was exactly in line with our expectations, based on the investments that we're making in areas of growing the business and in areas of meeting regulatory and compliance requirements, either through the Global Standards programme, which addresses anti-money-laundering and sanctions, or through wider regulatory programmes, which address the need to create automation and stability around, for example, stress-testing processes and regulatory reporting, such as COREP, FINREP and the like. It addresses a wide area of investment and, needless to say, there was some aspect of inflation reflected in those first-quarter numbers.

As ever is the case, there is a long and distinguished list of projects that the teams are working on to realise productivity within that cost base. We were reasonably successful in the first quarter in moving that forward and actually pulled the costs in slightly under our plan for the first quarter, but it would be entirely accurate to say that the profile of costs saves set out for the year are second-half-loaded. Part of that reflects some of the investment that is being front-end-loaded, with respect particularly to stress-testing for example.

Carla Antunes da Silva, Credit Suisse

Just a question on the four geographies that were mentioned in the full-year presentation, there have been a lot of newspaper articles and commentary around it. The question is: when you've been looking at the performance of these divisions and the intention for them, is it a one-year return on risk-weighted assets? Is there a time constraint, just to get an idea of how you would be assessing them and what timeframe as well?

Iain Mackay

We'll talk about that in a great deal more detail on 9 June. The timeframe that Stuart talked about at the end of the year has not changed. The rhythm that we follow with those businesses hasn't changed either. We have calls that involve Stuart, Marc Moses, the heads of the global businesses and myself, on a two weekly basis, with each of those geographies and with other businesses, but the other businesses tend

to be focused on individual-specific issues that we're interested in. On those calls, we go through volumes coming through, volumes and margins coming through each of the lines of business within those legal entities.

We look at a wide range of topics, in terms of their effectiveness at implementing Global Standards, and it's basically a walk through the data, against a set of targets that has been set for those businesses, in terms of whether they're meeting or are they falling short of them. If they're meeting them, prospects of maintaining and building momentum? If they're falling short, what are they going to do in terms of corrective actions? That is the rhythm that we've followed with those businesses now for, in some cases, considerably more than a year. I think it's fair to say that the intensity has gone from sitting, going through that with them once every four to six weeks to now every two weeks. I'm sure they really enjoy those calls. In a number of instances, whether it's our calls or whether the calls have simply resulted in a more intensive focus on the ground but, in a number of the instances, it's actually bearing fruit in terms of the results coming out and progress being made, not only in terms of the financial performance, but also in terms of meeting some of the compliance and conduct requirements that have been set for the businesses. We'll give you more detail on the 9th.

Martin Leitgeb, Goldman Sachs

I was just wondering if you could provide a little bit more colour on the scope of the strategic review. Obviously since the announcement a few weeks ago of the investor update in June, there has been relatively limited additional colour, mostly relating to potentially making GBM more capital efficient, as you commented on the call on Tuesday. I was just wondering if you could comment maybe on how broad is the scope of the review taking place currently.

Iain Mackay

Stuart said on the call on Tuesday that what you should not expect is an about-face on strategy. This is not setting a completely new strategy for the group and we're suddenly going to start investing in coal or gold, or something like that. This is going to focus on what works well in the group and there are a lot of things that work well in the group. It will put even more focus on the things that don't work well and you've mentioned a few of them. Some of them are geographies; some of them are global businesses. The thrust of it will be how we maintain momentum around those things that actually do work very well, when we do generate strong returns, where we are building market share, where we're making progress against some of the conduct and compliance aspects that face the industry as a whole.

We'll spend even more time focusing on the things that don't work and what we're doing, either in terms of fixing them to make them work because we believe they're important to the group or fundamentally restructuring or – and don't read too much in this – if we believe that they're not important to the group, what actions we may take to move them out of the group.

We'll put a lot of attention on costs, because it is clear that, with some of the pressures coming through the cost base that we can't control, the bank levy of which is one, in terms of being very focused on generating a return and paying a progressive dividend to the shareholder, it's important that, one, we get the cost-efficiency ratio in line with the targets that we set out; that we establish the capability on a sustainable basis to generate positive jaws through the businesses and through the legal entities through which those businesses operate, and that we generate a return on equity.

If I boil it right down to the basis, it is how we move from a return on equity today that is below 10% to a return on equity that's above 10%. That's what it's about. Without talking out of turn – and Stuart said this on the call – don't expect us to suddenly change the name to something else and start investing in shipping or something. That's not what this is about. This is about giving you more insight about things that work well and those that don't. Most of you know the things that don't and what we're doing about either fixing it or removing it from the construct of the group.
What I will ask you at the end of this meeting, by the way, are specific areas that you would like us to address, so you can be thinking about that now. It doesn't mean we'll address them, but at least I'd like to know what you want.

Sandy Chen, Cenkos Securities

Following on from that and focusing on GBM, thanks for the disclosure in terms of GBM by the regions, because I found that quite interesting. I was wondering if you could just talk more about contrasting Europe versus Asia in GBM, because obviously the PBT is far less volatile in Asia than in Europe. Could you talk a bit more about how that translates into cost-income ratios, return on risk-weighted assets?

After you talk about that, what can be propagated from the Asian model of GBM to Europe or can some assets be transferred from Europe into Asia?

Iain Mackay

Sandy, if you could only transport Asian markets to Europe that might be one thing. That's what it boils down to; it's the nature of the markets in which we operate. The Global Banking and Markets business has been a globally run business for many years now, and the risk appetite, the limit structure, the trading behaviour and the way in which the business is managed are highly consistent across the four main booking centres that we've got, which are London, Paris, New York and Hong Kong. We've got trading rooms that, in some cases, consist of no more than a couple people, in many locations around the world. Our main booking centres are the four that I've mentioned.

The characteristics of the underlying markets are what inform the stability and the performance of the business. Now, when you get to the cost-income ratio, it's the structure of the labour markets within those same markets that tends to inform the cost-income ratio. It is a people-intensive business.

What I would remark is that, excluding the fourth quarter, which was abysmally bad and had very high allowances and provisions made for things like fines, penalties and settlements going through Global Banking and Markets – in the fourth quarter, there was $550 million alone as it related to foreign exchange potential settlements. Beyond that, the cost-efficiency ratio for Global Banking and Markets globally is probably the best in the industry, in terms of comparison to our peer group.

In terms of the profitability of lines of businesses within Global Banking and Markets, we will go into a lot of detail on that, the principal focus being on it is a business today that does not generate a return on equity greater than 10%. There are parts that do, but there are parts that don't. Again, as Stuart mentioned on Tuesday, there are parts of that business that cyclically do not today, but are enormously important to the franchise. Payments and Cash Management and Security Services is an example. Payments and Cash Management is probably the most important, when you consider where interest rates sit just now. They are, nonetheless, enormously important for the franchise. It creates a very strong bond between the Bank and its customers, and there's probably one product line where, regardless of the fact that its returns aren't as strong as we would like presently, the focus will be on improving those returns under current market conditions and not with a view to exiting it, because it's absolutely integral to what we do as a bank.

There are other aspects within the business where the focus will be on reduction of risk-weighted assets within those lines of business. In some cases, though again I'm not going to, as it were, trace out exactly what we're going to say on the 9th, but it may well result that there will be a couple of lines of business there that we would curtail completely. The underlying differences between Asia and Europe are the markets in which they trade, the volumes and the economic environment that those markets represent.

Sandy Chen

On the RWA point, is there a difference in terms of the shape? Well, there are obviously differences in terms of the shape of the businesses, but relative risk weights – there might be some cross-regional arbitrage depending on where you book it with.

Iain Mackay

Our risk-weighted asset regime is global in nature. It's informed by the PRA. If you were to do it locally, then yes, there would. If we did it on an HKMA basis versus a PRA basis, then yes, it would look

different. It doesn't as far as the group's concerned, because we've got a global construct for our RWAs, informed by the PRA and CRD IV.

Within the $520 billion of risk-weighted assets sitting inside Global Banking and Markets, $70 billion of that relates to balance sheet management. It is our corporate surplus. It consists of high-quality liquid assets and there are about $44-45 billion of which relates to legacy credit, principally the SICs and SIVs, which is progressively being run off. Again, areas where we can accelerate the run-off of unproductive assets, then we'll talk about that in a little bit more detail. You knock over $100 billion worth of risk-weighted assets out of that $520 billion.

One of the things that we may consider, just to make life a bit easier for you guys, is frankly disclosing balance sheet management outside Global Banking and Markets, going forward. When the market does do an analysis, they tend to forget that balance sheet management sits inside Global Banking and Markets.

Manus Costello, Autonomous

If you take that out, can you put the levy back into GBM?

Iain Mackay

The levy's already in GBM. We do not allocate the levy, and it's been a very purposeful and conscious decision. We do not allocate out to the legal entities and to the global businesses, but the business that attracts the lion's share of the levy is Global Banking and Markets.

Michael Helsby, Bank of America Merrill Lynch

Just on the question of re-domiciling, in the past you've talked a lot about the European returns and how they're depressed significantly because of the substantial costs that are associated with head office. Things get moved here or booked here. Can you talk about how many costs are originated outside of the UK, which tend land here in Europe, if any?

Iain Mackay

None.

Michael Helsby

Then what percentage of costs – I'm just trying to think around what we need to consider – what percentage of costs in Europe would shift out to other regions if you did re-domicile, just broadly speaking?

Iain Mackay

There was an interesting article – I can't remember if it was in the *FT* or the *Times* – last week, which talked about the fact that the UK tax contribution was down, because all of the costs for the headquarters were stuck in Bank plc, which is the UK operating entity, which is rubbish. In the UK, there's a tax regime that allows for tax consolidation within the United Kingdom. The holding company sits in the United Kingdom, for the moment at least, and the costs that we incur, many of them are what are called shareholder costs. They're not allocated out to the businesses, because it's not appropriate that they be allocated out and, if they were, they wouldn't be allowed for local tax purposes. Many of those costs sit inside the UK and sit inside UK tax consolidation.

Generally speaking, they are not costs that are attracted to Europe or to the UK from outside those jurisdictions, with the exception of, we have, as do most other market participants, operating centres that sit in locations around the world, like China, Malaysia, India and Poland, which undertake activities for the businesses, whether it's supporting mortgage processing, credit card management and suchlike. Those costs naturally come back to the businesses, because they're just processes that they run for it. Beyond those processes that, if you like, have been moved from those businesses in the first instance to

operating centres where we streamline and run global processes, there are not costs that are attracted back to the UK or the European environment.

Beyond that, we'll talk a little bit more about the HQ location question on 9 June, but we won't give an answer. This is a complicated matter. We obviously have to look at it from a financials perspective, cost-benefit analysis. Does it actually make sense economically to have the HQ sitting somewhere else? We also need to go through a wide range of approvals that, were the decision made to relocate the HQ, there's a wide range of approvals that would be required from various authorities around the world. Notwithstanding the fact that the analysis may lead us to conclude that the HQ in the UK is not the right place to put it, and I'm not prejudging that analysis, the ability to effect any change will be dependent on obtaining approvals to do so. That's just one of the complexities that sits within the analysis.

We'll certainly talk more about how we're looking at it, some of those complexities and why they are complex, but not necessarily how we would resolve them, because I'm not sure it's clear to us right now how we would resolve them. We'll provide you with a bit more detail about how we're evaluating that decision on the 9th, but I can be absolutely definitive and say that there will not be a decision on 9 June, because there simply is not enough time to do the work between now and then.

Michael Helsby

In GBM, obviously the focus across the group is on return on risk-weighted assets, but do you have an eye on leverage when you're looking at returns in GBM as well?

Iain Mackay

We do. Leverage ratio has not been a constraint for us, as a group or at a legal entity level within the group. We measure leverage at a legal entity level for obvious reasons.

Michael Helsby

It filters in more with the levy going up, doesn't it? Is that something that you take into consideration?

Iain Mackay

It's a consideration, absolutely.

Mike Trippitt, Numis Securities

A couple of questions. I guess what's made you revisit the strategy on 9 June is clearly regulatory change over the last couple of years, getting to a point where we know now what the CET1 ratio should be, but there are obviously some big moving parts in that ratio still, in terms of risk assets.

Iain Mackay

I'll probably take exception with your reasoning there, Mike, but carry on.

Mike Trippitt

The reason I say that is, I guess, we were originally looking at a 12% ROE on a 10% CET1. That sort of relationship has been inverted; we're now looking at a 10% ROE on a 12% CET1. My question is really: how do you take into account further regulatory change? The usual suspects, review of the trading book, risk weights, risk floors, etc., how will you accommodate that in your thinking on 9 June? That's the first question.

The second question: I just wondered if you could talk through a little bit of the pull factors of re-domiciling. I think we've got an understanding of what the push factors are, but what would be important in terms of re-domicile location?

Iain Mackay

If you read John Gapper's article in the newspapers this morning that will give you a pretty good sense as to the pull. The way Stuart expressed this earlier in the week was just, if you think about where the greatest economic opportunity is for the group, should the heart and mind of the management of the group therefore sit at the heart of where that economic opportunity sits? That's a significant element of the pull.

Hopefully have been clear and will continue to be clear about is this is not, and absolutely cannot be, about regulatory arbitrage. It cannot be about that. We cannot headquarter the group in a location that is not well supervised and not well regulated. Unfortunately, much of what's written in the British newspapers is woefully ill informed about the competence of the capability of regulators around the world. It is not about regulatory arbitrage; it is absolutely not and cannot be about that.

We cannot have the group headquartered somewhere where regulators – and we are supervised by many regulators around the world because of our corporate structure. We have separately capitalised, funded, governed, supervised in virtually every market in which we operate, which goes to the multiple point of entry resolution construct that we continue to work through with our principal regulators here in the UK. If, at any point, any of those regulators around the world felt that we were headquartered in an area that didn't provide good home-country supervision and regulation, it would, in our view, diminish the overall value of the group from that particular stakeholder's perspective. Frankly, it would diminish the value of the group from a shareholder's perspective as well.

This is not about regulatory arbitrage. It's an economic decision. There are clearly factors that are influenced by regulation that come into the calculation and the analysis from an economic perspective. There is a 'push me, pull me', but you shouldn't read too much about the push me aspects of this being about regulation in the UK.

There is one factor, which nobody is that sympathetic to, but it is a competitive challenge for international banks headquartered in the European Union, and that is CRD IV compensation. When you sit down a prospective employee in Hong Kong or Singapore or the United States or Brazil, and say, 'Right, this is your comp. It's capped at this. It's going to be deferred over three to five years, and it could be clawed back for seven,' they look at it as if you've got six heads. They can go next door and get paid with maybe a three-year deferral and no claw-back. It just is a serious competitive issue. The UK Government understands this perfectly, but unfortunately has not been able to persuade their continental friends on this matter. It's a serious competitive issue that needs to be addressed.

Mike Trippitt

Sorry, just about the first question about the regulatory whole load of developments here on RWAs, how do you accommodate that in your thinking? Maybe that's one for the list at the end. I don't know.

Iain Mackay

Carefully, and Jane can talk to this in more detail. Do you know how our revised approach to standardise is going to turn out? Do you have any insight as to what the fundamental review of the trading book is going to turn out? No. That's precisely the point; we don't know. We, like other market participants, have engaged very actively in the consultation process. We are engaged very actively in the QIS processes around this. I think we've got a regulator in the UK that is very engaged and very concerned about this, and is working closely with the UK banks to work through the detail behind it. In terms of the shape of it, the colour of it, the size of it –

Jane Leach, Head of Group Regulatory Reporting

I think it's fair to say that the big things on the horizon are those sorts of things that you've just mentioned – the standardised approach, the standardised floors, the fundamental review of the trading book, the operational risk standardised approaches. These are global things. There is a lot of uncertainty at the moment on those, because it has to work through the Basel process. Clearly calibration's at an early stage. That is well known and it's well known on a global basis.

The CRDIV buffers and the UK interpretation of those, as we said at Q4, have become clearer over the last six months. It's not completely clear. We don't know where we're going to end up on ring-fencing buffers. There are elements where we don't know where we're going to end up from an implementation perspective on counter-cyclical buffers and so on, but some elements of that have become clearer over the last six months, which is helpful. That's where we are overall.

Manus Costello

Can I just follow up on that, Jane? On that list, you didn't include CVA risk-weighted asset. The EBA put out a paper, earlier this year, talking about really quite meaningful hits to the banks if and when that exemption is removed.

Jane Leach

That's not the same scale as the sorts of conversations around standardised approach for credit risk though. If you look at the shorter-term risks, there is clearly a risk that we'll get some of the CVA exemptions coming under challenge and potentially removed. That's not immaterial, but it's not as significant as some of the longer-term things I mentioned before.

Manus Costello

Does that form of words mean you're not going to give me any kind of numbers around that?

Jane Leach

I'm not going to give you a number at this stage, no. It's a way off on that. There's still a lot of discussion going on.

Manus Costello

Alright, thank you. One number which you did mention, just to carry on the RWA theme, is this $12 billion increase in market risk due to a hedge position. You mentioned it briefly on the conference call, but can you give us some more indication about what that about and the step-up?

Jane Leach

To be clear, not all of the $12 billion was the market risk position that we are talking about today. There are other things in there as well, the general growth in several areas. The particular IRC position was basically a hedge that was placed on interest rate positions. The way that the IRC model works that we actually lost in diversification benefit through that and the positions that it was on are quite highly calibrated, so this attracted quite a lot of RWAs. What we are doing, as part of the GBM initiatives around RWAs, which we'll no doubt talk more about on 9 June, is having a look at a number of areas. One of the areas we're looking at is the calibration of the IRC model.

Manus Costello

This has nothing to do with the sterling hedges you put on?

Jane Leach

No.

Ian Gordon, Investec

Two please: firstly, just back on the re-domicile, a very simple question. From where you take the decision, roughly how long will it take to implement it?

Iain Mackay

It's a great question. I know, but I'm not sure I want to share that piece of information. We've got a pretty idea. The timeframe is informed by one of the areas that I mentioned, which is approvals. Once we made a decision, assuming all approvals are received quickly, you could actually make it happen quite quickly. I think the challenge here is that some of those approvals might quite take a long time to get hold of.

Ian Gordon

You're thinking months, not years.

Iain Mackay

No, you're talking about a couple of years' worth of work. This is not a telephone call approval. There's a lot of work involved around this.

Ian Gordon

Specifically the date on which you may cease to have your full current UK bank levy liability would be a couple of years out.

Iain Mackay

I can't speculate on it, because how approvals stack up, what transition process you've got to go through, who supervises you during those supervision processes – the list goes on and on. Our goal is to do the analysis, make a case, make a recommendation to the board of directors. I have no doubt that recommendation, regardless of what it will be, will be debated and challenged at some length, and make a decision. Once there is a decision made, either swing into action or do nothing.

Ian Gordon

On Hong Kong and, to a lesser extent, you've already talked about the equities business within GBM, but can you talk a bit more about the very strong performance in Hong Kong retail? I know you referenced it in the document and on the call, around the strong wealth management earnings. Do you characterise these as having an annuity step-up or just a flow impact or what?

Iain Mackay

Again, if you go back and look at the Retail Banking and Wealth Management business in Hong Kong, you get a very close correlation between the performance of the equity markets in Asia and the performance of our RBWM business. They are very active investors, whether that's an insurance-related product, whether it's foreign-exchange-related or whether it's an equity-related product.

One of the factors, certainly not the only, but one of the factors that impacted the first quarter was the Shanghai-Hong Kong Stock Connect, which got a lot of people excited. Volumes were really quite low to start with but, as the quarter built and certainly into April, those volumes have continued to build. We certainly have a very, very strong technology platform in that area, which allows us to handle a lot of volume coming through that arrangement. That was one of the factors.

We had a lot of interest coming through the insurance business, in terms of investment products in that regard. You saw that step-up in terms of the net premiums in insurance and you also saw it coming through the net claims and liabilities to policyholders, because they've got participation features in a lot of the policies that we issue in Hong Kong and France in particular. The Retail Bank in Hong Kong does respond to market volatility, and that tends to present an opportunity for improving the revenue base there.

At the risk of misquoting John, I think he was just very happy, and satisfied frankly, that a lot of hard work, in terms of repositioning incentive schemes, repositioning some of the product offerings across the Retail Bank wealth management business actually showed up as an increase in revenue in Retail Banking and Wealth management, for the first time in quite some time. It's the first year that we started off without a re-cut of the incentive programmes, across either the Retail Bank or the Asset Management business. Therefore, we've got a distribution of sales force which is hopefully a bit steadier and more stable. It was encouraging to see an increase in revenue coming through Retail Banking. It was principally coming through Asia, but we saw that showing signs of improvement in both the US and the UK as well.

Chris Manners, Morgan Stanley

Two questions, if I may. The first one was on stress-testing. Obviously the PRA's going to be more focused on market stress, international business stress. I'm just trying to work out here what you're thinking about that, in terms of how you meet the 3% leverage ratio that is going to be incorporated, how you're running the stress tests concurrently with all the other stress tests. I guess you've got many stress tests being run through the Bank.
Also, how do you think about the threshold? I know the US authorities are thinking about maybe including banks' G-SIB buffer in the threshold. Would your Pillar 2a, for example, be included in the threshold for a test? Maybe some thoughts around those.

The other bit was maybe just to find out a little bit what you think about the UK retail and commercial business. We had soft revenues out of some of the other UK banks, apart from Lloyds. How do you see the competitive dynamics there? I guess you'll try to take a bit more share.

Russell Picot, Group Chief Accounting Officer

We are in full stress-testing gear and mode. There are some significant changes from last year, quite a significant expansion of the data set. We're being asked to deliver a five-year horizon for projections, rather than a three-year horizon. You've obviously been through the macro topics of stress and all the variables.

We finished the initial process. We are pretty close to having all the assumptions signed off, and everything primed and ready to go. In terms of process, the process will be better than it was last year, but we are clearly on an investment phase and it will be better still in 2016. You picked up on the leverage ratio; that was not a requirement last year. Now it is a requirement. Our leverage ratio, at 31 March, is a touch under 5%. That's quite a strong position to start from.

It's not particularly clear how all the buffers might fit into the PRA's thinking at the moment. Obviously they've published their consultative paper. We and a number of banks have sent in our comments so, at the moment, that's not the formal PRA policy. That's probably where we are. We are running at least three stress tests at the same time. We're running PRA. We're running DFAST in the US and we're running a test for the Hong Kong Monetary Authority. That sort of feels normal in the stress-testing world.

Chris Manners

Can I ask you, before we had a 4.5% stress test threshold, could they start chucking in a D-SIB on top of that as a pass mark? Pillar 2a looks like it's a requirement rather than a buffer. Would that potentially be included in the pass mark? I'm thinking 16-plus.

Russell Picot

It's not a stress test then, would be my argument. 2016 beyond, Chris?

Chris Manners

Yes.

Russell Picot

I suspect what we think is that this will get refined by the Bank of England and the PRA. There's also a prudential policy aspect and a macro-economic consideration, because the FPC also looks at sectoral considerations. It's a reasonable expectation to expect the methodology and the process to refine every year. It's much more difficult to say, in the year 2015, 'That's what 2016 is going to look like. That's the shape of what a pass mark might look like for a G-SIB or indeed a D-SIB.' Those ingredients you'd expect to be at least considered by the regulatory authorities in the UK, as they run through this. As far as we know, the European Central Bank is not running one so far this year.

Jane Leach

No, there's no information about that.

Russell Picot

The EBA's collecting some additional data or templates.

Iain Mackay

I would have described the trading conditions within the Retail Bank and the Commercial Bank as reasonably stable, because the mortgage market is incredibly competitive. We've sort of kept a very stable risk appetite around the UK mortgage market. Our share has certainly dropped off from 2013 and 2014 levels, but I think we're sitting around about just over 5% of stock at the moment in the UK. That's down about 1.5 points compared to the end of 2013, for example.

In the round, I would say the environment's reasonably positive. We've taken a couple of actions within the Retail Bank recently, which did affect fee income coming through the first quarter. That was we started a texting message to customers that look as if they're about to create an overdraft. Rather than hit them with large overdraft fees, we give them the opportunity to rectify that. If they do not rectify it, then we hit them with overdraft fees. As a consequence of which, and entirely logically, when people receive a text from us saying, 'You're about to go overdrawn,' they do something about it. As a consequence of which, we've experienced a drop-off in overdraft fees in the UK. I think it's just one example of what John and his colleagues have done in the business, which is a very strong focus around the right outcome for customers to encourage the right behaviour from customers. Where the initial form of encouragement doesn't have the desired effect, then a slightly more monetary form of incentive takes effect – but that has adversely affected fee income in the first quarter. But overall I would say Commercial Banking and the retail bank are fairly constructive in the UK at the moment.

John-Paul Crutchley, UBS

Two questions for now: one on the US commercial bank and, secondly, on the ring-fencing proposal in the UK. The commercial bank in the US is obviously one of the growth strategies. It seems to have gone back both Q1 and Q4 and year-on-year. Is that investment driven or is there any particular reason why that's had a weak performance in the first quarter?

Iain Mackay

That's a good question, JP. I'm not sure. It's not been a particularly material move in the US.

John-Paul Crutchley

It's not material in the Group context, but…

Iain Mackay

Yeah, it has been strong on growth, but it's a small business. It's a business that, having sold the upstate branches in New York, started virtually from scratch again about two years ago. So, the business has been driven, to a significant degree, by West Coast business – but the growth has been reasonably consistent. And we are very much in an investment cycle where we've still got recruitment going on in

terms of those RMs that operate in the middle market that have got an international focus, so we have been fairly robust in terms of tracking those down from competitors and attracting them across to HSBC. But that is the investment cycle.

Yeah, we're a little bit off in Canada, but, again, that is a well positioned business in Canada, the commercial bank in Canada. As I've said a few times, if we could replicate our Canadian business in the US, we'd be very happy.

Russell Picot

I think there was a prior-year gain in the US in Q1.

Iain Mackay

We'll look into it with the team and clarify.

John-Paul Crutchley

The question on ring-fencing: some of the comments you made publically around the unattractiveness of the UK ring-fenced entities are quite clearly at odds with what some of your peers are saying. I'm just wondering why you've been so vocal on that point, given that in a ring-fenced entity you'll be the only shareholder and, ultimately, the management will be there to deliver for the shareholder, which is yourself. But you seem to be very cautious about the construct that's being articulated, and I'm wondering why that's the case.

Iain Mackay

With the exception of one obvious competitor in the UK, the other UK participants are basically ring-fenced banks already. You look at Lloyds: they probably don't have a great deal to do from a ring-fencing perspective. RBS seems to be headed sharply in the same direction – and Santander. I think it's probably Barclays and ourselves that have a principle challenge around it.

But around principal concern is the degree to which that ring-fence is electrified. We could be the 100% shareholder, but can we, in actual fact, exercise appropriate management control over the strategy, the capital management of the Bank. And the Board is required to be independent. The Chairman must be independent, which means he can't be ex-HSBC. If he is ex-HSBC, he has to be at least five years ex-HSBC and have no pension. At least 50% of the Board is to be independent, in addition to the Chairman. The concern is the degree to which you have 100% shareholding in a substantial asset, which probably represents fairly attractive returns, depending of course on where they set capital TLAC and leverage requirements for the ring-fenced bank.

But at the moment our model would suggest the returns are probably quite attractive in the ring-fenced bank, but it does come down to the extent to which we can align it with Group strategy and exercise reasonable management control over that entity. That's really the extent of the concern.

John-Paul Crutchley

From a philosophical perspective, how does that differ from the ownership of Hang Seng Bank, which clearly is an independent entity? And you are very much happy with the situation there.

Iain Mackay

Well, it is, but it's slightly different. We own just about 63% of Hang Seng. We've got a significant number of directors from HSBC on the board. The CEO is HSBC or ex-HSBC. There's a lot of management talent in there that has grown up through the ranks of HSBC, and the two banks don't compete in the same space in Hong Kong, which perhaps sounds bizarre, because it's a relatively small market, but we don't compete in the same space – but there is a very close linkage between the Hang Seng management, the HSBC management and the respective boards.

And other than the governance construct of the number of boards of directors in our shareholding – and we've got a significant minority there, which, obviously, as a Hong Kong minority, are very vocal in terms

of what they want the Bank to be able to do – what is concerning is the fact that we can own 100% of something and conceivably not control it.

Chintan Joshi, Nomura

Can I do a couple of details before we go back to re-dom? Just back on Chris' point on Europe, if I look at RBWM and CMB, it looks weak – even adjusted for FX. You hinted on Retail being partially about fee income, but even on the CMB side I see a similar story. FX adjusted, it still looks weak. I'm just trying to understand why it's looking weak on a year-on-year comparison or on a quarter on quarter basis.

Iain Mackay

So, in CMB, last year was a good year. It started from 1 January and progressed throughout. There's a comparative element as it relates specifically to CMB. In Retail Bank, it is relative to the marketplace, where mortgages have been weaker in the first quarter. The yield on mortgages has compressed a little bit. That's been, to a significant degree, compensated by the cost of funds, which has come down. Overall, for example, in the UK our net interest margin has actually improved in the first quarter, I think by about 20 basis points. But that's largely been coming through the cost of funds as opposed to through the asset yield.

That's a year-on-year comparison, not quarter-on-quarter. I think those are the main factors. We had a very good last year, particular the last half of last year in Commercial Banking. In the Retail Bank in the first quarter, it's weakness in the mortgage space.

Chintan Joshi

Can I get – in case you have it in your data pack – the weighted average cost of deposits in the UK? You used to give it in your annual report two years ago, but you've stopped since then. I'm just trying to think if you're the cheapest in the UK space.

Iain Mackay

The gross cost of funds in the UK has been remarkably consistent over the year. It's about 65 basis points.

Chintan Joshi

That's deposits, right?

Iain Mackay

That's the gross cost of funds year-to-date, so it's all-in.

Chintan Joshi

All-in, okay. If I go back to Asia again, you highlighted that there's strength in Wealth Management. But it's really strong: RBWM in Asia is up 6% and CMB is up 4.5% underlying. What is driving that? Is that repeatable through the coming quarters?

Iain Mackay

In terms of Retail Bank Wealth Management?

Chintan Joshi

Both RBWM and CMB.

Iain Mackay

Again, I think you've got to take a read-across from how the equity markets are performing in Asia. I think we got a boost in the first quarter from Stock Connect. We'll see how that holds up. The volumes have actually developed even further in April. I wouldn't put all my eggs in that particular basket, but it certainly helps. The environment in Hong Kong, I would say, is reasonably positive. Net interest income

grew. That's all over Asia, but, if I go to Hong Kong specifically, it grew 3.5% from a net interest income perspective.

Chintan Joshi

Year-on-year?

Iain Mackay

Yes.

Chintan Joshi

Just a final detail on PPI and FX – you didn't provide for it. All the other UK banks were providing.

Iain Mackay

We put another $90 million up for PPI in the first quarter and the model has remained consistent over the last couple of years. It is driven by inward claims experience, our upholding of those claims and payment against those claims. We've re-evaluated from time to time as to whether there's a way to see through to the end of this, but frankly we don't think there is. We've investigated different ways to it, so the approach we've stuck very closely with – which is why you see adjustments quarter to quarter – is based on inbound claims and the uphold and payment rate against those claims. Our claims experience in the first quarter was kind of 'steady as she goes' so what we did was update the provision to reflect slightly less than an 18-month forward coverage. We unfortunately think there's another 18 months to two years of this to run.

Chintan Joshi

That would be bullish. And FX?

Iain Mackay

We took $550 in incremental provisions last year. In addition to that, there was the provision for the settlement for the CFTC, which I think was $270 million in the fourth quarter of last year, and then obviously we settled with the FCA on our principal review on controls. The total last year we took was just under $1.2 billion and that represented settlement with the FCA, settlement for the CFTC in the US and then a provision for ongoing investigations by the DoJ, the Fed and the OCC.

Chintan Joshi

Okay. I guess it means you feel comfortable with the provision you have now.

Iain Mackay

There's a lot written in the press about five banks being in a negotiation settlements with the DoJ. We're not one of them. That doesn't mean we won't be, but it means we're not at the moment.

Chintan Joshi

Moving on to the re-dom issue, the TLAC document says EM headquartered banks will be exempt for the time being.

Iain Mackay

If we were to relocate to Hong Kong, it's not EM.

Chintan Joshi

Okay, fine.

Iain Mackay

We think the EM thing is highly appropriate, but most EMs tend to be heavily deposit-funded, but I think one of the things we represented was that, if there's going to be an EM exemption, it should be for banks

operating in emerging markets because the funding model is highly similar. That's not what was suggested by the original proposal, but it's certainly part of the consultant feedback that's been provided.

Chintan Joshi

That will disadvantage all Hong Kong banks against non-Hong Kong Asian banks.

Iain Mackay

Mainly Chinese banks.

Jane Leach

China is expected to be part of EM, but Hong Kong is not.

Chintan Joshi

When you think about the re-dom issue, do you feel there would be a change in perception of cost of equity, if you were UK domiciled or Hong Kong domiciled?

Iain Mackay

That's a great question. I don't know. To be perfectly honest, I haven't thought about it. It's part of what we do. Do you think there would be?

Chintan Joshi

A little bit.

Iain Mackay

You mean our costs would go down, right, Chintan?

Chintan Joshi

I wish.

Shailesh Raikundlia, BES

Just a couple of questions. One of them, follows on from Chintan's question on the strength of CMB, is that I'm just wondering what sort of trends you're seeing in the first quarter in trade and cash management, especially in terms of margins, obviously there's been a lot of pressure there.

Iain Mackay

Stable both in margin and volume, for the most part. Margins, for the last five quarters, have been up or down a basis point or two. The only geography where we've experienced real spread compression – and it's been across a number of product ranges – has been Latin America, where we've seen a higher cost of funds. As we've re-mixed portfolios away from unsecured to secured, we've seen more yield as that portfolio has remixed. So, we have seen margin compression in Latin America. Some of that is just driven by local cost of funds and some of it is driven by virtue of our own actions to de-risk portfolios.

Shailesh Raikundlia

The second question is on re-dom. I was just wondering there would be a significant change in RWAs if you were to move – obviously, if the PRA is your lead regulator and you move on to the HKMA, for example – especially in terms of the way models are calculated, advanced models, IRB models and operational risk as well. Does that mean there would be a significant change in the way RWAs are calculated going forward?

Iain Mackay

To be determined – part of the work we're doing. Again, until you get into discussions, one we've got to make a recommendation to the Board and a decision needs to be made. And part of the analysis is, if

there were a different home regulator, how they would apply their regulatory regime to us. Do they do it on a global basis? Do they do it based on equivalence with other regimes? There is a lot of variability and complexity within that, which will be part of what we'll evaluate for the Board.

Shailesh Raikundlia

Sure. I am just interested in a sense of the direction. Given the fact of what the current regulation is, for example, the HKMA versus the PRA – would that be more onerous or less onerous? Do you have any idea of which direction it will go?

Iain Mackay

Having experienced it in close quarters – having dealt with the HKMA for a couple of years out in Hong Kong – they are a robust, rigorous regulator. They're proactive; they pick up the telephone and call and say, 'These are things that concern us. Provide us with insight,' and then they form a policy and implement very quickly on the back of that policy formulation. They've got a clear framework based on Basel III around risk-weighted assets. That framework is applied within our HBAP businesses, because the Hong Kong Monetary Authority is our principal authority for the HBAP businesses, along with the Monetary Authority of Singapore – equally robust – CBRC in China – equally robust – Reserve Bank of India – so on and so forth.

But the regime is grounded in Basel III. It's not the construct of CRD IV, so the regime is somewhat different. One area which presently does not exist within that regime – but that does not mean it wouldn't in the future – is loss-given-default floors on sovereigns, for example, where the PRA introduced a 45% loss-given-default floor on sovereigns outside the European Economic Area, which means US Treasury's get a loss-given-default floor of 45%, whereas Greek bonds don't – as an example. There are aspects of the implementation of Basel III which exist. There are variances. If you go to the Dodd-Frank Act in the US, it's different again. If you go to the way Canada or Mexico has implemented Basel III, there are local nuances to it in each and every regulated entity we've got.

But one of the discussions conceivably with thee HKMA, if the conversation got to that, would be, 'How do you want to regulate the Group?' Is it on an HKMA RWA regime globally or would you view equivalence of how the Fed does it, how the Mexicans do it, how the Canadians do it, how the UK PRA does it? Do you view those regimes as being equivalent or would you want us to apply an HKMA model globally, which, when you then think about how we would recalibrate and rebuild models, is a not insignificant piece of work.

These are some of the interesting questions that need to be addressed.

Jason Napier, Deutsche Bank

Two, please. The first is on the UK stress test, you said that the assumptions are pretty close to being signed off and so on. I just wondered what sort of standard deviation around the final result looks like. I can't imagine that there's a huge amount the PRA will see fit to adjust over the next six months, given the complexity of the Group. It's either your model or, you'd think, none. So, I just wonder how much clarity you have over the result, given you know what the assumptions are; it's your data set.

Russell Picot

And given that I haven't run my models yet, Jason.

Jason Napier

No, I'm not asking for the answer. I'm just wondering when the Board looks at the strategy day in June and look out at least over the next 12 months, how much visibility you think you have over the next round of tests.

Russell Picot

By the time we get to 9 June we'll be getting numbers coming up to Group. But it's a long process. So, when we make our submission in mid-summer, the team fall over and take a big sigh of relief – but actually that's the beginning of a new process, which there is a quite lengthy, detailed discussion with the specialist teams at the PRA, risk area by risk area – sometimes that can be country by country. For example, last year they basically took the seven UK domestic businesses and compared and contrasted them. So, that process takes weeks. They then go through an internal process, and there can be further challenge coming from the internal process. So, it is a quite long process – and you only really know right towards the end, to be fair.

Iain Mackay

Certainly, based on last year's experience, as a consequence of that review and challenge process which Russell set out – by the way, we have our own internal review and challenge process, which includes all the way up to the Group Risk Committee of the Board, there are changes and amendments made both by us to the way we run the models and the outcomes we realise as well as by the PRA, informed either through discussions with the Financial Policy Committee or as a result of the review and challenge they do with us in each area.

Jason Napier

The second one is just around UK mortgage volumes. My sense is that gross numbers are down this year on last year. 2014 was down on 2013 and 2013 on 2012. I appreciate it's a competitive market, but now you have Countrywide you do have a cost advantage, capital looks good; returns are good. Is this a disappointing outcome or is it in line with the plan that you'll be printing lower volumes in UK mortgages?

Iain Mackay

I wouldn't say it's necessarily disappointing. I think the team in the UK started a third-party sourcing arrangement. The number of loans we've actually closed as a result of that third-party sourcing arrangement has been very small. We've got an underwriting scorecard that's pretty strict in the UK, and there are elements that others are lending into that we are just interested in. There's also been a slowdown with some of the segments we historically have operated very well in. I don't think we're losing market share; I think there's just been a slowdown in those segments.

Whether that's informed by uncertainty around the General Election, I don't know. It'd be unfair to comment. But, no, volumes are down, absolutely: 2013 over 2012, 2014 over 2013. And that was absolutely a function of a much more competitive environment, where frankly we've been not willing to move to some of those competitive areas.

Gurpreet Sahi, Goldman Sachs

On the re-dom, do you think a fact that has to be considered also would be any one-time tax implications and then the equality of the talent pool that is available for headquartered human capital in London versus Hong Kong?

Iain Mackay

Those would be two factors we'd consider, certainly. I don't think we're particularly concerned about the capability of the talent pool in Hong Kong.

Gurpreet Sahi

Could you explain some of your thinking around those factors? I know it's still in the works.

Iain Mackay

It is very much still in the works, yes. What do you want me to say, sorry?

Gurpreet Sahi

No, I'm just asking for any colour around those two questions.

Iain Mackay

You'll get colour when we've got the colour to give you – when I'm at liberty to do so.

Chintan Joshi

Following up on that point, what are the benefits of staying in London? We've talked a lot about the benefits of moving out, but how do you think about that?

Russell Picot

I mean, there are pros and cons. Moving a head office – having done it once in the reverse direction in 1992 – is a big deal.

Iain Mackay

True, it is a big deal.

Russell Picot

And it is a decision that isn't taken on a very short-term basis. It is a long-term decision.

When you weigh that up, you have to think about everything.

An obvious comment is that, given the geographical footprint of the firm, it's easier to run a head office from London because of the time zone. That's one of the benefits of being in London.

Iain Mackay

This is stating the glaringly honest, but this is not a decision that the Board will take lightly. It's a generational decision. This is not something you change your mind on every five years; you just can't do it. You can't do it for your shareholders; you can't do it to your staff; you can't do it to your regulators. You'd have no credibility. This is a long-term decision about the long-term future of the Group, and therefore there's a lot of work that needs to be done; there are a lot of authorities that need to be consulted. When we've gathered together the evidence and made the argument one way or the other, it'll be put to the Board with a recommendation and, because of the importance of the decision, it will not be taken lightly.

Michael Helsby

In the UK retail and commercial bank, you made a big deal more recently of emphasising the trade and international focus of our business in terms of growth. I was wondering if you could give us an idea of how important that is in the revenue pool of the commercial bank in the UK and, I guess, more broadly in Europe, more linking into Asia. If that's spun off, you'd probably lose a lot of it.

Iain Mackay

Perhaps a better example of this is our German business. Up until the end of 2013, our German business was a Global Banking and Markets business – and that was it. No commercial banking, no retail banking. And in late 2013 to early 2014, we started a Commercial Banking offering very much focused on the international Mittelstand. And the German business has hit their numbers from a targets perspective pretty much from day one. And it's looking very encouraging – and it is all internationally orientated. If you want to do banking between Stuttgart and Frankfurt, you don't do it with HSBC; you'll go and do it with Commerzbank or one of the Landesbanks.

But when it comes to banking internationally, the ability to attract commercial bankers that have that interest and focus has actually been very encouraging in the German marketplace. I think it's actually done a good deal to strengthen the quality of the brand of the bank in Germany. There's much greater awareness in the commercial space. I was actually over there in Berlin, speaking at a dinner a couple of weeks ago, and the brand is held in good regard. And part of that has been reinforced by a move to support a wider element of the middle market in Germany.

In the UK it's important, but in the UK there's a mix. The UK is the old Midland bank and it had a commercial banking business as well as a retail bank, and there is still a very healthy mix of domestic-domestic business within the Commercial Bank in the UK. But we've put, over the course of the last two years, special funds in place at the beginning of each year – and those funds are exclusively for the purpose of supporting companies that are trading internationally that perhaps are new to the Bank or are only just starting to move internationally. I've got a couple of customers in that space which I'm the sponsor for, which, interestingly, are in the oil sector and that would not have been trading internationally had it not been for the fact that we helped them get going in that regard.

It's not the largest part of the UK business, but it's an increasingly important focus for us. But in other areas – the US is one, Germany is another example where we have put a lot of capital on a relative basis – it's not a lot of capital for the Group – to work for those legal entities to build the middle-market banking business. It's a promising area for us.

Michael Helsby

If you spun it out, though, do you think you would you lose…?

Iain Mackay

Everybody is getting ahead of themselves on this thing. As we were talking about earlier, we've got a ring-fenced design that we think is more or less buttoned down that we need to get approval from the PRA from. That ring-fence would be basically Retail Banking and Commercial Banking, and those are two profitable businesses for us in the UK. Depending on what kind of capital and TLAC leverage requirements are placed on the ring-fenced bank, at least based on our modelling, which is based on what was talked about at the time the ICB made its recommendations, it would suggest that's a profitable business for is.

If it's a profitable business for us and we can exercise reasonable management control over it from a capital management and strategic management, there's no reason why we wouldn't retain it, right? The two decisions about where we are headquartered and what we do in the UK are two very different decisions. As Stuart said, a relatively small proportion of our 48,000 employees in the UK are employed by headquarters. The vast majority are employed by Retail Banking and Commercial Banking in the UK, and that proportion which is in Global Banking and Markets in the UK is a very small proportion of that 48,000. You take headquarters and Global Banking and Markets together and it doesn't even hit the 8,000 mark. There are over 40,000 employees in the Retail Banking and Commercial Banking businesses in the UK.

John-Paul Crutchley

I have a very quick one on semantics around the re-domicile question. It's literally just listening, because I think the comment the Board originally made at the AGM was 'considering the best location for the Group' and the market very much seems to interpret that as London versus Hong Kong. I just wanted to ask about those semantics. When you're thinking about the decision, is it London versus Hong Kong or is the Board thinking, 'Where in the world should the Group be located, with all the issues around regulation etc?' Is New York as credible an alternative as London and Hong Kong or any other jurisdictions? Has it been narrowed down in terms of the thinking just because of the historic location and footprint for the Group?

Iain Mackay

That's an important question. The Board asked us to evaluate the best location for a headquarters, and that's what we're going to do, but I think it is fair to say Hong Kong features high on the list of probable, possible and preferred locations for the headquarters other than London.

John-Paul Crutchley

But it's not automatic that those are the only two locations.

Iain Mackay

No, what the Board asked us to do was consider the best location for our headquarters. As you know, we looked at this 3-4 years ago. You go through, 'Right, Vancouver, New York, Melbourne, etc.' For a whole host of reasons they get knocked out – driven mostly by the economics of it and by market presence. Again, out in front, informed a little bit by Stuart's comments, is that, if you think about where the greatest economic opportunity is for the Group over the course of the coming 10, 20 or 30 years, is that likely to be New York? Maybe not.

Chris Manners

It's a quick one. I remember last year you were encouraging us to take out BoCom numbers in my model.

Iain Mackay

I was, wasn't I?

Chris

I put it back in my model. What should we be doing?

Iain Mackay

It's a really good question. We've still got headroom against the carrying value. Value in use is still a few hundred million above the carrying value. Obviously, the market value of BoCom has improved, as have most Chinese banks' market value over the course of the last few weeks – but market value is still considerably below the carrying value, and that's the trigger point for evaluating against the value in use.

Value in use is informed by a range of assumptions around the growth, the credit performance, the interest-rate environment. It's the usual kind of stuff you build into a discounted cash-flow model. We revisit that at least quarterly, based on information that becomes available around the performance of BoCom. I wasn't being disingenuous. At this time last year, we thought there was an impairment coming down the track fairly quickly.

Russell Picot

The capital generation is neutral to the accounting VIU test. So, we would continue to accrete our share of their profits to capital even if the accounting were to conclude that there was an impairment. Of course, when you think about the profit-generating capacity of the Group and our ability to pay dividends, the income recognition is one thing, but, obviously, the amount of cash that BoCom delivers by dividend is a smaller number. So, that's probably why I tend to not focus as heavily on the earnings piece as I do on the capital-generation and cash generation pieces.

Chris Manners

Thanks. The way I was thinking about it was that if it was an 8% reduction in year because of stated EPS, which might roughly be the impact, then the optics on the payout ratio would go up and you may start to get nervous on that.

Iain Mackay

That goes to Russell's point about the cash we get out of BoCom.

Chris Manners

If the cash is the same and the capital treatment is the same, actually maybe there's less impact than we should be worried about.

Iain Mackay

Okay, thanks very much for joining this morning. I'm sure we'll see you on the 9th. I didn't ask what you wanted to cover, apart from re-dom. Clearly we are going to disappoint you on the ninth, because we're not going to give you a decision. But is there anything else?

Participant

Costs.

Iain Mackay

Yeah, we're going to cover that in detail.

Participant

A lot of detail.

Chintan Joshi

If you keep business that are underperforming give us reasons why, clearly.

Iain Mackay

Absolutely.

Russell Picot

It's strategic.

Participant

RWA inflation – things we don't know yet.

Participant

Interconnectedness, as well – understanding the flows of revenue

Participant

All about that bit about Europe. Clearly, there's a lot of focus on how the shape of the Group might change, so having a forward view of what that might mean.

Iain Mackay

We'll address that.

Chintan Joshi

On that point, if the RWA inflation is indeed large, what kind of impact does it have on your strategic plans?

Iain Mackay

I'll go back to Jane's point: there are things on which there is greater clarity and there are things on which there is not. The notion of talking about a revised standardised approach or a fundamental review of the trading book we're not going to cover, because there's just not enough detail to talk about it intelligently, Chintan. Things like risks to capital from RWA inflation and other aspects – we'll touch on that, but to get into hypothesis around the revised standardised approach we won't.

Iain Mackay

Okay, thanks very much.