Transcript
Investor Update 2013

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Douglas Flint, Group Chairman

Good morning and welcome. My only task this morning is to welcome everybody to this Strategy Update. This is now the third that we've done, and I guess over the last two and a half years a huge amount has been achieved against that which was set out in the first one, so this is an opportunity to update on that, to describe the progress in a programme which is maybe approaching halfway through, but a long way to go, and Stuart and the team are going to take you through what the next phase will be. It's been quite a journey so far. Stuart and the team are all committed to take it to the next stage, so at this point let me hand you over to Stuart.

Stuart Gulliver, Group Chief Executive

Thanks, Douglas. Good morning. So, over the course of the next few hours – we promise it will be less hours than 2011 – we'll explain the investment case again for HSBC. And the order of the day will be as set out on this agenda, which is I'll start effectively by rehearsing what I think is still the distinctive position that HSBC has, even in the changed environment that's evolved over the last two and a half years, and then I'll go into actually quite considerable detail on what we've achieved in the last two and a half years, because although we live it every day, you're all investing in many companies and covering many different stocks. Then we'll go into, after a break, a detailed run through of the next phase of our strategy, and then we'll take questions and answers for about an hour, after which you're welcome to join us for lunch.

The management team is actually in the room, and the reason I want to take a break at one point is so that you can actually talk to them directly, and that also becomes an opportunity over the course of the lunch. But first, two summary slides, the first one being this one, which sets out what we actually have done since 2011.

So, we announced the strategy back in May 2011, and since then I think we have made considerable progress to transform and reform the HSBC Group. The key highlights include: there's been 52 disposals and exits announced since 2011, with 12 of these still to complete. There's been an $8 billion gain on sale, $4 billion in annualised sustainable saves and a headcount reduction of about 28,000 from those sustainable saves plus actually another 12,000 from the disposals, so headcount down by 40,000. We actually have achieved double-digit loan growth in 15 of our priority markets. We've generated $27 billion of capital and we've actually paid $16 billion in gross dividends. And I think as a management team, we've broken the treacly inertia that others feared would hold us back, and we've evidenced focus-management grip over HSBC, unlocking value for you all. As Douglas just said, we're not even halfway through the programme to reshape HSBC, and clearly some things did not go to plan, which I'll come back onto a little bit later on, and we'll be open and transparent about those as well.

And the second snapshot is what this presentation contains. This is the key takeaways from today, and I wanted to put it upfront just in case some of you were busy and needed to pop on somewhere else; and to save you having to march through 90 slides to get to the conclusion, we'll have it upfront here. So look, briefly, as we move to the next phase, which is 2014, I remind you that we're still on the 2013 targets obviously, funnily enough for 2013, and allow me basically to run through the strategy.

The strategy actually remains unchanged. It is actually working, so we're not changing the strategy. There are three priorities going forward: we're going to grow both the business and the dividends, and we're going to run HSBC for both. We're in unique geographies where the macro trends support investment, and we generate surplus capital, so we can fund growth and we can fund a progressive dividend, okay? What I don't want you to think about is we're running the company now simply for the dividend. There are a lot of growth opportunities. We're positioned, as I'll go through in some detail, in those geographies in the world that really will deliver the big difference in the next 20 years. So it's a great opportunity to invest, but there's also potentially a great opportunity to increase the dividend, and the logic will simply be we generate about 60 basis points of capital per year. If GDP growth supports it, we'll deploy the RWAs, the return will come back through PBT and dividends that way. If actually GDP growth is weaker then the capital generation will increase the dividends.

What we're also going to look at doing as well is, subject to PRA approval, and this will be from 2014, is to neutralise the scrip dividend programme. We won't abolish it because it's really important for our retail shareholders in Hong Kong, but obviously there's been a dilution really in the last – well, since the rights issue, actually of about 1.3/1.4 billion shares simply coming about through the scrip. So again, subject to PRA approval, and starting from 2014, we'll look to neutralise the scrip dividend.

We set out therefore these targets. We're sticking to the 12-15% return on equity. We actually believe we can achieve this because the underlying bank is achieving it. The dilution at Group level comes about because we have household and legacy portfolios that are running down and also because we have SIVs and conduits in the Global Banking and Markets business. If you put those to one side, we are actually achieving the 12-15%, and we're actually happy to reconfirm it with a higher Tier -1 capital minimum. What we're also saying is we're going to run with a Common Equity tier 1 minimum of 10% on a fully loaded CRDIV version of Basel III 2022 basis, and we're quite confident that we can still drive the 12-15 with that in mind.

The advanced deposit ratio cap will remain at less than 90%; it's actually 73%. It's a cap as opposed to a target, but we remain comfortably inside that, and clearly we continue therefore to signal that this bank will be retail deposit funded, which we think is again a substantial source of strength. We also are setting out $2-3 billion of additional sustainable saves. That will take us to a total of $7 billion of sustainable saves since we started in 2011 by the end of 2016. And that's why we're starting to move – we've focused heavily on sustainable saves to adjust the cost efficiency ratio. This clearly has been a miss. We're in a kind of situation where we've actually out-performed on the cost saves, we're at $4 billion in the first quarter of 2013, when we said we'd actually get to $2.5-3.5 by the end of 2013. But of course we've missed the cost efficiency ratio, and actually to be honest, that's mostly because we didn't foresee the collapse of the eurozone, which came almost immediately after the May 2011 Investor Day. And clearly the revenue is difficult to drive; you're all aware of that, and it wouldn't be the case that the Bank of Japan, the ECB, the Bank of England and the Fed all had QE if revenue growth was just pumping along and GDP was great.

So therefore, what we want to do is unhook ourselves from the inability to control the revenue because of big macro trends beyond of course taking market share, and we'll dig into some of that, and proof of concept to some of that a bit later on. But to reassure you, a very specific further sustainable cost save is now being set up. So we're going to run it in the mid-50s, but with also a focus on positive jaws. Clearly, positive jaws implies an improving cost efficiency ratio by definition, yes? And again, bear in mind that even if we're in the mid-50s, we're still a lot better than most of our peer group, who tend to be in the high-50s to low-60s. So we're going to be 100% focused on both unlocking and creating value in the Group, and realising that value both in the share price, in dividends and in other forms of capital return. So that's basically the output from today, and now we'll build up the kind of logic and detail as to how we've arrived at this.

So, I want to basically revisit, and I think it is logical to retest the validity of the strategy that we set out in 2011; in other words, is it still valid? And the fact of the matter is an awful lot has happened since 2011. The market environment has been very challenging, and there are several things we didn't expect in May 2011. First, the eurozone crisis and its impact on interest rates; interest rates are going to stay lower for longer. We've got $1.2 trillion of deposits, which therefore the net interest margin on will remain quite compressed. We saw a weaker than expected global macroeconomic performance, and out of the global credit crisis we saw a breakdown in trust in banks and sovereigns. So this has kind of resulted in stricter regulation and policies, which have continued to evolve, and actually evolve quite considerably since 2011. So we've got the EU interpretation of Basel III via CRDIV, ring-fencing proposals, Vickers in the UK; Liikanen in Europe, G-SIFI surcharges from the SFB, the Dodd-Frank Act in the United States, and most recently compensation restrictions in the EU under CRDIV.

So the outcome is obviously a significant change in the industry environment, and challenges on banks' profitability. All of this has happened in the last two and a half years, and actually the interesting fact, which you'll all be aware of, is the banking industry's increased its capital base by about 57% since 2007, while revenues remain mostly flat. So, effectively the industry has deleveraged. Growth outlook does remain challenging, which means banks will have to do a lot more discipline about managing their costs going forward, and Sean will talk in detail about this. And actually one of the things I think that's happening and changing in the industry is the banking industry will have to now manage its costs in the way most other industries have had to do for a very long time.

The banking industry in a way, probably because of three main trends, has not had to be as focused on its cost as manufacturing companies have had to be. The banking industry was able to reach, in the case of some of our competitors – not us – to high levels of leverage. The banking industry was able to reach to alchemy, which also we didn't do, i.e. making products that are worth two that you sell for 12. And the banking industry was also able to benefit from ever new emerging markets where the demographic wave actually resulted in entering new markets with very high spreads, which initially in the first 10/15 years of any developing market's development remained very high, and then eventually narrow up. That we have benefitted from, and that is no longer there. So we think we're going to be running this firm, basically each year challenging management to take 2-3% out of the cost base, and that's kind of what we would have been doing had we worked in the auto industry or pharmaceuticals for the last several years.

But I think all of these important questions therefore raise the issue of are the two major global trends which we actually set our strategy on, are they still actually valid? Well, the first one, if you remember, was our belief that the world economy was rebalancing, that there was a shift, a once-in-generation shift, of economic activity moving from the developed world to the emerging markets. We believe this trend remains completely valid, and it benefits HSBC because of our long history in those economies which will represent the greatest growth opportunity for the next 20 years. That still remains completely intact as a macro position that benefits this bank.

Secondly, we said as well that the global macroeconomic environment and the economic development and this rebalancing would continue. And since 2011, the global macroeconomic environment has actually deteriorated. But despite the slowdown, the fundamental trend is still intact, because if you look at the last two and a half years, faster growing market GDP has averaged three to four times higher than mature markets. So that effect of an once-in-a-lifetime shift to the emerging markets and the emerging markets themselves growing at a much faster pace has remained completely intact.

We also said that continued trade growth and capital flows to offset global imbalances would be a considerable beneficiary to HSBC given our geographic footprint. And we believe that this trend is still in place in terms of trade, but not in terms of capital flow. So if you look at this, and since trade is so critical I think it's worth diving into this in some detail, trade continues to grow but it's clearly affected by the overall macroeconomic environment. The fastest growing trade corridors remain those between mature and faster growing markets, which fits us, and the so-called south-south trade, which is emerging markets to emerging markets, which fits us.

Now, the cross-border capital flows have seen a significant decrease, and that's primarily driven by Western European banks scaling back their international activities to focus more on their respective home markets. In actual fact, although we didn't foresee this in considerable detail back in 2011, of course this has actually also benefitted us, because as those European banks pulled out of Asia-Pacific, particularly in the case of the French, out of the Middle East in the case of the Germans, and actually pulled back in Latin America in the case of the Spanish, we have been able to actually take quite considerable market share. So, in a funny sort of way, the decline in capital flows at this point in time, because of the cause of it, i.e. it was weakness in European banks in particular, has actually resulted in a beneficial effect to HSBC. So that underlying proposition again has remained intact.

So if you look at, in essence, these significant trends, and then map them to HSBC's ability to capture the opportunities the trends create, we have a meaningful presence in many attractive growth markets, which allows us to take advantage of organic growth opportunities. We're one of the best capitalised banks in the world, and we have a stable funding base in deposits. And we're obviously very committed to these strategic markets because we've been in them for a very, very long time. You know, we've not just woken up to some of the opportunities that exist in Asia-Pacific or the Middle East. And our network covers about 90% of all global trade and capital flows.

The other big advantage we have is we have local balance sheets, liquidity in local currencies, which actually is a very heavy and high-entry-level barrier just at a micro level if you want to do high yield bonds in Asia, because an awful lot of these are actually in domestic currency. Unless you've got a domestic deposit base you actually can't do this. And we also have local trading capabilities in the most relevant financial hubs, so I continue to believe that we have key competitive advantages.

We are also present in the most attractive markets. We have meaningful exposure to growth through our presence in the most attractive, mature and fast-growing markets. Now our priority markets cover about 58% of the total addressable banking revenues growth to 2020 based on data from McKinsey. So what it's trying to do is to say, 'Look, what's the addressable revenue pool that a bank can get at?' okay? And what we've done here is we've excluded from the addressable banking revenue retail banking in the USA, mainland China and Germany, because we're not going to be able to – we don't want to in the USA, regulation won't allow us in China, and we do not have that business strategy in Germany. So this is the addressable wallet that actually HSBC can aspire to get to. And clearly if you look at this, you can see essentially that we are positioned across most of that opportunity, a very significant chunk of that opportunity.

Now growth is projected, if you look at this, to be concentrated in mainland China, Brazil, India and the US. And a study by Boston Consulting Group projects there'll be approximately 10,000 billion dollar companies by 2020 versus 4,000 in 2012. And the majority of these companies, over 60%, are going to be from faster growing markets where HSBC has an established presence, such as China and India. So these are markets where we have a presence and can capture a meaningful share of the available wallet.

Let me spend a bit of time on China, because this is an incredibly important country for HSBC, the clue clearly being in the name. So if you look at China, we actually don't need thousands of branches to capture a meaningful share of the economic development. This is a bit of a myth that actually a number of people have adopted. GDP growth and the commercial banking opportunity are highly concentrated in city clusters, okay? I think that you need to recognise that actually in most countries there is a move towards urban or city clusters, the creation of conurbations rather like the Tokyo-Kawasaki-Yokohama conurbation in Japan. So GDP growth and commercial banking opportunity are basically concentrated in city clusters, and these are defined as areas within a radius of 100-200 km, covering several large cities. Now the top 10 city clusters in mainland China are forecast to cover 70% of total GDP and international banking revenue opportunities between 2010 and 2025.

Now for example, the cities in Guangdong Province, and that's a map of Guangdong Province, which is mainland China's greatest exporter, and it contributes 11% of China's GDP, with Guangzhou and Shenzhen, are both populations of over 10 million. And what we think will happen here, and this is the big growth opportunity in Hong Kong, is that actually as the border becomes more porous, Guangzhou, Shenzhen, Hong Kong will become a conurbation; it will become a conurbation of 45 million people. And, you know, the factual analogue you need to think about is Tokyo-Kawasaki-Yokohama. That's the big growth opportunity. So using CEPA, the Close Economic Participation Agreement between Hong Kong and China, because The Hongkong and Shanghai Banking Corporation is a Hong Kong listed entity, we're allowed to open 20 to 30 branches per year in this province. So we will be able to build up, and this is in addition to the branches that we're opening in the rest of China. So the focus will be on this conurbation.

If you look across the rest of China, we are in all of the big urban clusters, the city clusters which represents 70% of the GDP opportunity, and most importantly, 70% of the Commercial Banking and GBM opportunity, because that's the bit that we can address. So the idea, when you look at this and say, 'Well, you know, you've got 150 branches and you're opening 30 a year, maybe you're at 400 branches in due course, big focus on this conurbation, how can you compete against a local Chinese bank?' Well we're not. We're not trying to do Retail Banking Wealth and Management. We're trying to actually represent the fact that we've got the biggest international network, and therefore as Beijing goes through its going overseas policy, we can connect Chinese companies and British, German, French companies, etc, to that opportunity. And you need to be in those city clusters, and we're in those city clusters, because you don't need a pan-Chinese strategy to do this.

Then specifically, and this is really important, this focus on essentially Guangzhou, Shenzhen and Hong Kong as a conurbation is part of the growth opportunity for our Hong Kong business. And this is actually really quite exciting. And as I say, we have under CEPA, completely alongside the CBRC approval process for, if you like, national branches, the ability to open to 20 to 30. So who else can do this? Well, Bank of East Asia can, and Dah Sing Bank can, but you need to be a Hong Kong incorporated listed bank to take advantage of CEPA. So actually American banks can't. So this is also something where clearly since Hong Kong is, and this is, you know – this is the Cantonese speaking area, we have tremendous brand recognition, because by definition, most people in this area are watching kind of Hong Kong satellite TV every day, are travelling backwards and forwards as the high speed railway is put in place, and this will become essentially a completely connected economic corridor.

Now again, in terms of size of network, we also get criticised for the size of our network in Brazil. You know, the idea is we are subscale, and the size of our network in India, where it's taken us since 1854 to get to about 55 branches, so a disappointing rate of opening, to replicate the UK branch network it's about the year 3020, by which time we'll all be well over doing investor days. But actually again, in Brazil and in India, it's the same argument. It's all about city clusters; it's all about urban clusters. There's really good work that the Brooking Institute have done about this. So again, in Brazil, the top 10 city clusters are forecast to cover 80% of total GDP, and 80% of the international commercial banking revenue growth between 10 and 25. In India, the top 10 city clusters are forecast to cover about 40% of total GDP, but 70%, again, of the international commercial banking revenue growth, which again is a concentration of where your export industries sit. In both cases, we have meaningful coverage within our existing network of both of these.

Now, going on to the network, the network continues to cover, post disposals, 90% of the international trade and capital flows. So trade and capital flows connectivity remains concentrated in 38 markets. They represent about 90% of growth. This was the case two and a half years ago; it remains the case today. And our network covers actually 90% of the global trade and capital flows, so we're well positioned to capture trade, FDI, FX reserve growth, external debt growth. The 22 home and priority markets cover 64% of trade growth, and 60% of FDI flows. And I'll come on in a moment to define the home and priority markets, but you can remember, I'm sure, this from the last couple of years. And so therefore, in many ways we believe that our business benefits from Metcalfe's law that asserts that the value of a network grows as the square of the number of its nodes. In our case this means we have to be present in the places that are key for global connectivity, yes? And the disposals in no way have impaired this network during the last couple of years, because clearly we did the analysis before we did the disposals.

We also still believe, rather self-evidently, in the advantages of a universal banking model. We believe that there are tremendous benefits, and that by being diversified by customer group, by geography and by activity, it creates tremendous stability. What of course has changed is that HSBC is now materially more focused post disposals and reorganisation than it was in the past. And actually, I think we've now started hopefully to build as a management team some track record around focused execution.

So I now want to talk about effectively the track record in delivering change, what we have done over the first phase. For those of you who follow us intimately, I apologise, some of this will be repetitive. But I think it is worth spending a little bit of time going through this almost as a report card to report back to you, our owners. So, as you've seen, the macro trends still support HSBC, so now let's look at what we've actually done. But first I want to make rather a simple but actually quite powerful point. If you read the transcripts of the 2011 and 2012 Investor Updates, we have attempted what we said we would. It seems rather a simple comment, but it doesn't seem to be often the case with banks in particular, over the last couple or few years.

So the vision that we articulated for HSBC, and defined for HSBC, and this is a really key slide, has a very logical sequence. So starting with our purpose, we defined the reason why the Group exists. It's extremely important actually for your internal community of your colleagues to define why on earth the firm exists, okay? And actually, obviously for most banks, no one ever gave any thought to this for a large part of recent history. You know, why does a bank exist? What's the point of it all? So we actually have set out, and I won't read it out to you, a very, very clear statement of why this firm exists and what it does, yes? And actually to be honest, and this is a bit of side-bar, it's incredibly important for your recruitment. So if you're going to get graduates now from university to want to join this industry, which is key if we're going to bring talent in now that eventually will be leading the firm, they have to think that there is a purpose and there's a value to what the firm does. It is no longer good enough to have a complete unstated or not-thought-through reason as to why your firm exists.

The second thing we did is we rolled out a very significant programme around values, and these are set out here as well, but this is incredibly important because it defines how we behave at HSBC. And we started this from January of 2011, and clearly this is part and parcel of helping us deal with the deferred prosecution agreement and the events that have taken place also around customer redress and so on in the UK. You have to be able to shift the soft side, the behavioural values of a company as well as the kind of hard financial targets. We've set out a strategy, which I've just re-checked against these significant macro trends, so if we believe that trade and capital flows will continue to grow, which we do, we capture it through Commercial Banking and Global Banking and Markets. If we believe that the emerging markets, economic growth is shifting from the developed world to the emerging markets, then we will capture that faster wealth creation in Retail Banking and Wealth Management and private banking. And the outcome is actually that we would deliver consistent returns with what we think is an appropriate balance. And the appropriate balance generally was set out as a mix of 50-35-15; 50% retained to build capital, to create a buffer to protect the taxpayer from any economic accidents that we might have; 35% to go to our owners, the shareholders; and 15 %to the staff. And we thought that that was a logical and sensible and supportable balance.

What we're effectively illustrating here is we're going to shift it slightly, because we have now got to a position where we believe we have sufficient of a capital buffer to meet regulatory requirements, which is kind of 9.5%, to create a 50 basis points clear water between that, which is what the 10% is about, and therefore we're going to shift this to a 45% of earnings retained, 40% dividends and 15% in terms of compensation to staff. And we'll talk in detail about how this dividend shift sort of takes place, but this is an important marker to put down. We're quite clearly signalling that the mix of the appropriate balance we're nudging towards dividend growth. And again, it's clearly going to come about that if economic growth is not at a level to consume the additional capital we're creating, we will return it to our shareholders. And what we want to do though, and expect to do, is to be able to do both. We expect to be able to grow the business and to be able to grow the dividend. But as I say, there has been some confusion, I think, around in terms of what our attitude to this is, so that's why we're clearly setting out here what it is.

So what we also just need to quickly bounce through again is the unexpected things that happened since May of 2011. And this is by way of really explaining and accepting the fact that we did miss the cost efficiency ratio. We missed it mainly because of revenue, because we didn't foresee what was going to happen to the eurozone and QE, and we also missed it because we – and this is a mistake that we as a management team made – we underestimated the size of the underinvestment in compliance and legal, so there is a permanent increase in cost there. We also, I think, arguably should have had a better sense of the severity of the regulatory enforcement actions in the USA, and indeed the size of the customer redress in the UK. On the other hand actually, there were also unexpected opportunities that came up. There were opportunities to invest in certainly the emerging market businesses, which we also didn't predict, in May of 2011, that have clearly generated positive jaws. But we clearly did miss on certain things; a) because certain things reduced our revenues, which were kind of unforeseeable, and b) because of internal, if you like, specific to HSBC things that we probably should have had a better handle around.

But we have made material progress over the last two years, and despite these events we generally have – and this is key – I think we have shown an ability to change HSBC, to reform it, to transform it, and to get our arms around this Group and actually manage it. A lot of the criticism of HSBC historically has been that it's a very large bureaucratic organisation, this treacly inertia comment that you'll recall was made after the first Investor Day by one of the newspapers. And I think what we've indicated now is that actually we can drive significant change. So we've announced a total of 52 disposables, we've cut 40,000 off the headcount, $4 billion off the cost base, and actually we have increased revenues in faster growing regions by 25%. There's been a 20% increase in Commercial Banking revenues over the period. It's been double digit loan growth in 15 out of the 22 priority markets. And I think all of this, which has clearly generated capital dividends and has led to some re-rating of the stock, comes about because we're showing much greater management grip on how we run the firm.

So we set out initially the five filters, which I talked about on the very first day, which we've run every business and continue to run every business through, okay? So this is a continuous process. This is not a one-off event. So we continue to run everything through: what is the strategic relevance to the country? Is it going to be in the top 30/40 economies in the world? What's its connectivity by trade and capital flows to other economies? Once it's through that, then there are specific ones about HSBC; how profitable is it, what's its cost efficiency ratio, is its AD ratio under 100? And therefore you come with decisions, if the connectivity and economic development is high, of invest, turnaround or improve: if it's low, continue as is; if we're hitting all of the profitability and liquidity targets or exit. Then we've also added a sixth filter, which is about global risk standards, and this is clearly about financial crime risk, and it's fairly obvious why we would need to do this and would need to actually clearly future-proof our business against ever having the kind of terrible situation that happened to us in the 2002-2008 period in Mexico and the United States.

The six filters have therefore led to an unprecedented number of disposables and exits. The six filters framework helped us to identify a large number of non-strategic businesses in our portfolio, and there have been 52 disposals and exits. There are 12 that are still to close at this moment. In the past, from 2000-2010, the Group redeployed capital in a number of acquisitions across different geographies and business lines, and clearly some of these acquisitions were not successfully integrated into our business. So if you look, there's quite a contrast. There's a period clearly from 2002-2010 where we invested and bought things, and in the period from 2011 to now we have disposed of a number of investments to make the firm easier to manage, easier to control, more focused.

What, I guess, I'm also saying is that therefore we are unlikely to redeploy capital into any significant M&A deal. And there are three reasons for that. One is we're already in the top level of G-SIFI. We're already amongst four banks that are regarded as the most systemically significant. So therefore we're unlikely to get regulatory approval for any big transformational deal. Secondly, we've exhibited quite clearly a great ability to run our Bank organically, and a less great ability to do acquisitions. And then the third thing is I think it is much more likely, given that we will deploy the six filters on any acquisitions, that any acquisition that does take place, I'm not ruling them out, would be in-country and as a bolt-on. So they're going to be in countries, most likely in the two home markets, the 20 priority markets, where we are also – and this is kind of a seventh filter – absolutely confident that our Bank has great management, great people and can completely dominate the target that we're actually taking on. So therefore what I'm really saying is that any acquisition will be bolt-on, it will therefore be quite small, it will therefore be in the obvious set of countries, and in those countries where we can absolutely dominate any target that takes place. It is therefore most likely that our growth will be organic, and that's actually a good thing because we've got a very good track record, Commercial Banking, Global Banking and Markets, of building businesses organically.

So if you look at an overview of the 52 disposals and exits, which makes the firm much more focused, in the US we're repositioning the Bank. We disposed of the cards business and the upstate New York branches. These were two large transactions in which we achieved a very positive outcome. We had further major transactions across Panama, Ping An, disposal of various of our insurance businesses, and at the same time the six filters identified a number of small, non-strategic businesses, which rather than strengthening the Group were subscale, consumed a disproportionate amount of resources and management and/or created substantial potential risk for compliance issues. So the firm is actually, I think, made much more fit for purpose by what we've done over the last two and a half years.

We've also refocused our associate investments. So we have two major associate holdings, which are strategic: Bank of Communications in mainland China, where we're continuing to strengthen collaboration. And you should just be aware that we have a joint programme going between Bank of Communications and ourselves, with me leading it from the HSBC point of view; Helen Wong, who's our CEO in China, running it day-to-day; and now Chairman Niu of Bank of Communications, who was President Niu until just recently, and was promoted, running it from the Bank of Communications side, because the Bank of Communications – and we both know that people don't buy HSBC stock for us to go and buy another listed stock that they could buy themselves unless we can clearly demonstrate that by having that shareholding we do more business between the two banks. So there absolutely is a programme, and clearly where the focus is, is the coming overseas policy. Because actually, BoCom, through its access to HSBC, has got the biggest international network: ICBC is in 34 countries; BoCom, by virtue of its connection to us, is in the 70 to 80 countries that HSBC sits in.

So there's a significant work-stream focused on doing this, and we would expect, possibly not in 2014, but certainly in 2015, to have the Chairman of BoCom here at Investor Day. He has agreed to do so, to talk to a couple of slides, but actually talk about the work between BoCom and HSBC. So we're critically aware of what the issue for you all as shareholders is, and that's why we are putting a great deal of effort into being able to demonstrate that there is a value to HSBC shareholders from us having this stake in BoCom.

Saudi British Bank has been a bank that we've had since the late 1970s, where we have the management contract, we have the maximum shareholding you are allowed within Saudi Arabia, and this has been a longstanding and profitable operation, which is the core part of our Middle East strategy. There are two that we have classified effectively as available for sale: Industrial Bank and Bank of Shanghai. So if I take each in turn.

Bank of Shanghai is actually quite modest. It really isn't something that frankly will move the dial as and when we do whatever we do with it. It's probably worth $5-600 million. So, one should really not spend too much time on it. Industrial Bank is obviously owned by Hang Seng Bank, and it's up to Hang Seng Bank's Board to decide what they do, but the change of accounting treatment is clear signalling as to what the intention is for Industrial Bank. And clearly during 2012 and closing in the first part of 2013, we completed the sale of Ping An.

I also want to talk a bit about the progress we've made in running down and de-risking the US legacy portfolio. This is clearly a run-off business, and we have made progress this year in selling the non-real estate piece, which is the little grey bar with 'four' in it at the top of the sort of red bars. And that basically closed in April, so that's now being sold. We expect the book to run down to about $20 billion by 2016, which will consist of about sales of approximately $7.5 billion, and a run-off charge-off of about $13 billion. So by 2016, the residual piece will be about $20 billion, based on what we see today, i.e. what the property market looks like at this moment in time as opposed to forecasting either a considerable improvement in it, or deterioration in it. So that's a kind of freeze the economic conditions in the property market today, look forward. That's where that book would run down to. So it continues to basically become less and less of an issue for HSBC as we go forward, and this is also clearly part of what releases capital and releases that RoE, because this is the dilutive bit. And the other dilutive bit is obviously the asset-backed securities held and available for sale in the SIVs and conduits.

This again continues to run down, and again is being run within Samir's area, on the basis of looking wherever we can and wherever the maths work to create release of capital to actually run this book down. It's harder to put a number on how this will run down because it doesn't have to have a natural kind of run-off the way the mortgage book does. It is worth reminding everyone that actually back in 2008 there was an AFS reserve of nearly $18.9 billion negative against this, which is actually now actually completely come back. So when we said then that actually the distortion was largely due to illiquidity, and actually that the underlying assets were reasonably strong, that has actually so far proven to be the case. So that AFS reserve negative has improved actually by about $17.5 billion over the period since 2008.

This is incredibly important. It's a deeply wordy slide, for which there is no other way of showing this, and it is however really at the heart of making HSBC easier to control, easier to manage, more focused? And this is kind of the biggest changes that we've had. We have created four global businesses. The firm, as you know, was run geographically. It was run in a very geographically decentralised basis, and there was a large problem of fiefdoms within the organisation. So starting in January of 2011 we created four global businesses, we created 10 global functions plus the IT business, so 11 in total, and five regions. And for the first time we said to the people running the global functions, 'You have total authority over all your people worldwide.' So if you're the Head of Risk, if you're the Chief Financial Officer, if you're the Chief Legal Officer, you own all the finance, legal, risk etc, people, HR people round the world. That was not the case previously.

Previously there would be direct reporting lines to the country head, and there would be a reporting line also to the function. But authority has to be clear. One of the problems in Mexico was there was a failure to escalate information. Failure to escalate information can be reduced, the risk of it can be reduced by effectively moving from a situation where you have the country head, so you've kind of got two eyes looking at the operation, you're reliant on the country head to come to the centre and tell you what's going on. Now you've got effectively 11 functions and four global businesses, plus the country head, so you've got 16 people who actually have an obligation to look at the risks in every country, so the likelihood of us getting to know, and the Board getting to know, that something is going awry is considerably greater by this organisational change.

It also enables us to manage costs and to manage capital allocation in a much more structured way than has previously taken place. So we've defined the global business and function. We've also started to

drive through consistent business and operating models, which is part of the reason why we've been able to take costs out. Because again, if you run this thing as 88 different retail banks, you could quite easily see there's massive duplication, or there's massive missed opportunities to get effectively systems, synergies or indeed cost savings. So, the last two years we've focused on delivering consistency and operational rigour across all our markets in recognition that the whole only works if we have all the parts lined up and marching in step. And we've also reduced unnecessary layers in the organisation. There's been a programme, again that Sean will talk about, to reduce the layers in the firm, this 8x8 strategy, so that no manager should have less than eight direct reports, and there should be no more than eight layers between myself and effectively the kind of lowest common denominator in terms of revenue producer. At certain parts of the firm in 2011 there were 17 layers, and actually there were quite a number of people reporting to themselves who did very well in their appraisals consistently.
So, what we've also done is to find across these four global businesses the activities that take place in them. So effectively we're doing 17 core activities. This is really most important. One of the big things that's put up against HSBC is, 'Okay, HSBC, you're a huge organisation, you're too big to manage. And you know what, because you stumbled in Mexico and the United States, you know, we thought you were quite well managed but obviously you guys can't get your arms around it either, so you should break all these banks up.' My retort to this is I think you can be big if you do a number of straightforward things. So if you effectively say, 'Look, there are four businesses, and we can undertake these activities in each of them,' then you can logically see how you can scale across multiple geographies. I think if you're massively complex, it's very difficult to be extremely big as well. But I think if actually you do reasonably straightforward things, it's possible. And this again is a very important element in simplifying the Group and dealing with this challenge.

And of course the most important thing in dealing with the challenge of 'Is it too big to manage?' is effectively about the talent. So the senior leadership team that lead the Bank have been subject to quite significant change. So we've changed roughly half of our management team since the end of 2010; five Group Management Board members and 19 Group General Managers have retired or left. The leadership team is now a strong mix of experienced HSBC executives and selected external hires. I think we believe it's always important and essential to inject fresh ideas from outside. We've also established strong connections between leaders across businesses and functions by forcing cooperation, and we've also basically established a talent pool and are looking to grow it.

So there are 250,000 people roughly in the firm – 254,000. So we're basically looking to populate a talent pool of 250, to move the number of Group General Managers up from 34 to 60, and the Group Managing Directors from 12 to 15. That would give us about 320/325 people that we can describe as the senior management of the firm. Because one of the things I would observe as the CEO of a bank is because of the way the industry is regarded in a very low way and a very distrusting way, there's been this kind of shift that really banks are sole proprietorships, which is where you get to this, 'It's too big to manage' notion, because you get this kind of thematic that something goes wrong somewhere in the world, and the CEO of whatever bank should immediately resign. That builds this notion that there's only one person running that bank at any moment in time, which actually if there was only one person, clearly this is a bit big to manage. But actually, I have 325 people in my senior management team.

You know, we're running something that's bigger than the UK armed forces, to put it into context, or the size of a small town, so therefore you would expect us to have a structure, and we have a structure. So that structure is 15-60-250, and we've brought together that senior management team a couple of weeks ago at an offsite to talk about this presentation that I'm going through today, to actually get consensus around those 325 people as to the fact that clearly we're going to go out and actually execute this in the next stage.

We're also therefore developing a talent pipeline. There's a lot of organisation gone around this, and we've also developed now very deep succession plans and a very deep succession planning document that for the top 270 jobs in the firm have successors named in the 0 to 12 months, one year to three year, and three year to five year for every job – well, for every job in the 269. That therefore clearly give us mapping; it also gives the Board sight to who the emerging talent is in the firm. And so this becomes effectively a document that I carry with me and use to actually move people around the firm, so there's precision around this.

I also think it's just worth talking again about two things. The international manager programme: this has been a defining programme for HSBC since time began. We continue to run it. The change we've made is as follows. If I look around at the Group Management Board and the people who attend it, and look at the 20 people, there's actually only three people who are international managers. If you go back to, say, 1997, the equivalent group, 100% would have been international managers. And what's happened is the international manager programme, as historically configured, not as now will be, did not equip international managers with the technical banking skills to become approved by regulators. So the international manager has tended to move around, rather like an ambassador in the Foreign Office, yes?

Now I want to change that, so what we've done is we've stopped taking international managers direct from university into the international manager programme. You join into commercial Banking, Global Banking and Markets, Private Banking, Retail Banking and Wealth Management, then after three to five years you apply for the international manager programme from within. You've started to pick up banking skills, you become both part of Commercial Banking and an international manager, part of global banking and markets and an international manager. Therefore 25 years into your career you will be able to get through the PRA, the Fed, the OCC's qualifications to rise right to the top of the firm. It's a really important part of our culture. I think it's therefore been reset to what we now need to create in a much more complicated world.

And we also continue actually to be able to attract quite a lot of graduates. This is quite important because clearly given our significant brand and reputational damage from the deferred prosecution agreement, we were quite concerned that we would actually find a drop-off. We haven't actually. Just recently at a leading European business school, 20% of the MBA class applied for a position at HSBC. So we're still seeing actually the firm as being an attractive firm to work for.

And again, just to take some diversity examples, 17% of the GGMs, 19% of the talent pool and 53% of our total staff are women, and we've got a total of about 28,000 Chinese staff in mainland China. And if we take the Chinese diaspora, there are about 80,000 in the firm globally.

I think we've also emphasised, and wish to reemphasise the extent to which we've made strong progress in transforming the organisation. We really have reshaped the portfolio, we've simplified the organisation, we've launched these four programmes to basically take costs out, and the costs have come out of the firm.

There has also, as I said, been considerable progress. We have achieved material growth in PBT in both Retail Banking and Wealth Management, put household to one side and look at the business that exists in the rest of the Group, and in Commercial Banking. And we've grown market share in these businesses. We've grown market share in Global Banking and Markets, quite clearly benefitting from the fact that some of our European competitors have been impacted. And we've also defined and broken the set of countries down into the home markets, the priority growth markets, networks and the small markets, and exited the rest. Again, if you start looking at 88 countries, what you very quickly discover is actually the two home markets account for of the PBT, and if you add in the priority and growth markets you're up at kind of 90% of the PBT, but you need the network markets to drive your trade proposition and to drive your payments and cash management proposition. You know, if you're not in some of the smaller countries you can't do Unilever or GlaxoSmithKline, Beechams PCM. You can't do the trade unless you're on the receiving side. But therefore the portfolio is now logical, but you can expect the bulk of our investment will go into these 22 countries, the home markets and the priority growth markets.

There's a lot of talk about there's little growth coming through, but I think this is quite an interesting slide. So there's been 12% GDP growth over the 2010-2012 period in the faster growing priority markets, and our loan growth has grown by 24%. So actually there is considerable growth coming through. This is my point about we didn't foresee this either. No, we didn't foresee customer redress in the UK, but we didn't foresee the opportunity of such spectacular GDP growth in a number of markets. So there has been substantial loan growth. And we have therefore maintained our position as the largest foreign bank in China, we've established 17 China desks globally. In India, we've turned round a loss making RBWM business. In Singapore we have leadership in foreign exchange, in advisory. In Indonesia and Malaysia we've got the top share in trade. Brazil, the loan growth and CMB is moving on at a sharp pace, and actually in Mexico we've grown our business as well. So it's quite clear that in the emerging markets there's actually been pretty good growth, quite honestly.

And then in the UK even, in the mature markets, we focused on growing our share of new mortgages, which is at 12% up from 9, and our share of UK trade finance, which has actually substantially increased from 13% to 17%. A clear competitive advantage for this firm is to connect UK SMEs with international business to the countries outside of or beyond the eurozone. In Canada there's been strong progress, in the US there's been strong progress, and even in France. So in the priority mature markets we've taken advantage of the dislocation of the market in order to be able to grow.

And even in Retail Banking and Wealth Management, which clearly has the legacy issue of the Household book, there's been substantial momentum. This was the most local and fragmented business, so this was the business that came furthest away from being able to be run as a global business. I think even now, and I think John Flint, who's in the front here, would agree with me that whilst the business is now governed globally, it's still not yet run today, today as such, and that's a journey which John will deliver for me.

But in all seriousness, to get something, and this is where the big cost opportunity is, if you run 88 separate businesses you've got multiple product variety, you've got multiple systems for IT. This is why we're confident we have the ability to take more costs out. It's because we in certain places have 9, 10, 11 different varieties of credit cards. We have 9, 10, 11 different varieties of the most basic things – cheque books, etc. All of that adds to your cost base. There are multiple variations on internet offerings and internet platforms. Just in the Retail Banking area there are 30 odd different versions of internet offerings, because it's been run decentralised, so everyone's developed their own. So rather than actually having one portal and having it in nine languages, you've got massive variety. The team can therefore take significant costs out by bringing this together.

We've also seen reasonably good progress in collaboration between Commercial Banking and Global Banking and Markets. The low hanging fruit we've captured quickly, which is internalising our own foreign exchange flow, and actually the big growth in high yield. We have a dominant now high yield position in Asia, where we have league table ratings of one. Again, go back three years, Morgan Stanley would have been one, we'd have been kind of outside it. Why has that happened? It's actually now the tight working relationship between Samir and Alan, between commercial banking, and global banking and markets, so that those SMEs are going to the high yield bond market with actually HSBC leading it.

So what the outcome so far has been is as follows. We've generated and retained about $27 billion in shareholders' equity since 2010. This has contributed to an increase in our CT1 ratio to 12.3% from 10.5%. That's despite the implementation of Basel 2.5, CRD3. We've made a total of $16 billion of dividend payments from 2010 to 2012. We were number two dividend payer in the FTSE and number five dividend payer in the Hang Seng, and I think we've seen a reasonably strong commitment from our top shareholders. 80% of our top shareholders at the end of 2012 were also in the top 50 at the end of 2010, so there hasn't been significant churn in the register. And more than 60% of the top 50 shareholders have increased their holdings of HSBC during this period.

If you then take a look at it from a share price growth versus the MSCI World Index, we've slightly outperformed the MSCI World Index, and this effectively, I think, is clearly down to some sense that we've rerated back to a price to book of 1.2, because we have delivered on what we said we would do in 2011. So that brings us up to date, that share price is at 10 May.

And now we're going to take a 15-minute break, and then we'll get into the next phase of the strategy. Thank you.

Okay, thanks very much for coming back. Let's get into the next section. I think we have hopefully given you the impression that we've created a lot more simplicity in our business model and actually some depth in our management team and we've got a clear plan for continued delivery. So let's focus first of all on the priorities.

There are three priorities. We are going to grow the business and we are going to grow the dividends. We are going to leverage our capital generation to invest in mostly organic opportunities. I wouldn't rule out an in-country bolt-on where we could dominate whatever we're bolting on. But mostly, this will actually be organic growth. We're going to progressively grow the dividend and, as may be appropriate, starting share buy-backs from as early as 2014, subject to meeting UK regulatory capital requirements and receiving shareholder approval.

We will, secondly, implement global standards, building a more sustainable business model by investing in best-in-class risk and compliance capabilities, and de-risking operations in higher-risk locations. We're going to continue to streamline processes and procedures. By 2016, the legacy and non-strategic markets' reduced impact on PBT and RWAs will make significant progress in implementing global standards, and we'll also have delivered the $2-3 billion of sustainable saves.

Let me first of all talk about how we're going to go about investing. There will be a process around this; there will be a structure around this. Just as we had the six filters to decide what we are going to keep and what we may buy, we will also create a structure of how we will invest the surplus capital to grow the business.

In 2011, we introduced the five filters, now six, which has been a great tool to determine what fits and does not fit into our portfolio. Based on the strong historical capital generation of about 60 basis points net of dividends per year, and our robust capital position, we have capacity for additional growth. Obviously it depends on what GDP delivers, whether we can grow, but we have the capacity to grow.

So, we have the capacity to do two things: to grow and to increase the dividend. Clearly we are going to prioritise opportunities within our portfolio and decide where we should invest, i.e. are we going to grow Retail Banking and Wealth Management in Brazil? Are we going to grow Commercial Banking in Turkey?

We are going to run the process in a very disciplined way. To decide where we invest additional resources going forward we will follow a similar, stringent framework, assessing investment decisions on three dimensions. First of all strategic: so every investment has to be aligned with our strategy, thus most of our investors will be in the priority markets, the two home markets and the priority markets; the investment has to be consistent with the risk appetite statement set by the Board; and it has to create value for our shareholders. There's a very specific purpose – this is a bit of a complicated chart to try and show – that effectively, we are going to do a focused, disciplined, capital allocation, with a focus led from the centre, with effectively the Group Management Board, chaired by myself, in effect, acting as a CIO as well as a CEO.

In essence, what happens is, we will deploy capital out, having approved at the Group Management Board that we want to invest, say, in Commercial Banking in Singapore. Actually, Singapore at the end of the year will pay a dividend back into the holding company. So we will take the capital out of the operating entities, and clearly then re-introduce capital sufficient to meet regulatory requirements. What we will not enable countries to do is to sit with their own surplus capital and therefore, effectively, get back to the situation we used to have, which for example, today, explains why we are the second-biggest credit card issuer in the Philippines, because the CEO five lots ago liked credit cards. That won't happen. So, effectively, capital will be allocated; RWAs will be allocated; profits will be taken out and then recycled back by Iain and his team in the most-capital efficient structure. So, therefore, at the centre, where the HSBC Holdings box is, you in essence have the Group Management Board and myself.
Clearly, at the centre we will also decide on what the distributions – which ultimately is a Board decision – are made to the shareholders in the form of dividends, or indeed in the forms of neutralising the scrip dividend or further share buy-backs.

So, this process is quite important and this is a very significant slide. This matrix shows you where we will believe we will allocate most of our risk-weighted asset growth over the next few years. So, first of all, 40% of it will be in Commercial Banking, going into the faster-growing regions. A huge chunk of it actually goes into Commercial Banking overall, so roughly 65% of the growth will go there. Then, 15-20% will go into Retail Banking and Wealth Management in the faster-growing regions. So if you look at this down the two axes, the businesses that will pick up the biggest delta of new RWA deployment, created by surplus capital, are Commercial Banking, in particular in the faster-growing regions; Retail Banking Wealth and Management in the faster-growing regions; and by definition, in total, the faster-growing regions. So, 70-75% will be going into the faster-growing regions, and 65% of that, within which, will be going into Commercial Banking. So, actually, directionally, this is where we are going to force the skew and the change in the shape of the firm.

Actually, if you look over the last several years, you can see that we have actually forced the start of that shift of the balance between developed markets and emerging markets.

Let me now go into specific global businesses. Commercial Banking is absolutely the jewel in the crown. The mission of this business, which I think is completely achievable, is to be the leading international trade and business bank. We grew our share of bank finance, world trade, according to Oliver Wyman, to 11%, and we have a substantial, I think, competitive advantage, given the focus on the city clusters I talked about, and the countries that we're actually sitting in. This business targets the 2.2%, the 2.5 return on risk-weighted assets, and there's a very high entry level barrier to compete in this business, for anyone to actually get into this business.

I just want to talk about a couple of client examples, to try and point out the difference for HSBC. These are three client examples of how we can leverage our international network capabilities to support clients expanding their presence.

Tangle Teezer started in the UK, manufacturer of hairbrushes in 2005, according to *The Sunday Times*. We've supporting them since 2011, and supported their expansion into 60 overseas markets. So that is a UK-to-overseas trade example.

We're working with LuenThai since the 1960s, when it was a small Hong Kong trading company. Over the years, we've supported its growth into a multinational group; it's active in manufacturing services, hospitality and logistics in 17 countries, now with revenues of $1.5 billion. That is a Hong Kong-to-overseas example.

Then the last one, which is Hisense, is a leading Chinese home appliance manufacturer. Our relationship began as recently as 2004, and we're now banking them in Hong Kong, Singapore, US, Canada and South Africa, and about to start banking them in Australia. There's the PRC-to-overseas example.

So here are some examples of why clients choose HSBC. We have an international network; we're on the ground in their country; we have a local currency balance sheet as well as an international capability; and clearly we have the products and advisory capabilities.

The growth opportunities in Global Banking and Markets are equally significant. We are well-positioned in several product areas that I think will benefit from powerful global trends. First of all, debt capital markets. The DCM business: you can actually already see this year in the developed world, an enormous jump in DCM activity and DCM fees, because what's effectively happened, post-LTRO and the funding-for-lending scheme in the UK, is that most banks can now access credit again, but actually very few can access it at credit spreads that are tighter than where their own corporates can borrow. So, therefore, their corporates are dis-intermediating them and going to the bond market. Therefore, you benefit from this if you've got a big DCM platform. Actually, that is why there's been this big jump in both investment-grade and high-yield. Yes, there's a search for yield, but the phenomenon is more that, if you're an Italian or a Spanish bank, yes, you can access the money markets again, but the price at which you can access it is generally higher than where your top-notch credits can borrow themselves. So they actually will go to the bond market. So, your DCM platform becomes critical; we have a significant DCM platform, which is why so far this year, which is a continuation from last year, we've had great results in DCM.

In project and export finance, you can see both in the developed world, in the UK, there's going to be considerable infrastructure expenditure eventually; and in the emerging markets there already is considerable infrastructure expenditure. We have considerable expertise and the balance sheet size to participate in this. The balance sheet size is important, because it also explains why we increasingly have a strong position in the event financing in the emerging markets. It is a $2.7 trillion balance sheet, so we're one of the few banks that can actually simultaneously finance three or four deals at $10 billion a ticket. Because we can do that, we can now also lock-in the advisory, whether that advisory is actually at a strategic level or it is at a financing and hedging level. That balance sheet heft in the past was discounted because there were many banks that could do this; there are now not many banks that can do this in the geographies in which we are actually left.

Also, we think there's a significant opportunity for us as the RMB internationalises; we clearly have an ambition to be the leading international bank in RMB, and we think this is a significant opportunity not just in trade, but eventually in payments and cash management, and indeed, in terms of foreign exchange.

Now, we said for a long time that we have a distinctive business model, and generally nobody believed us, but I think by this point in time, it's fairly clear that our Global Banking and Markets model is different than a bulge bracket investment banking model. It is based around foreign exchange, debt capital markets, payments and cash management, securities and custody. It is quite unusual as well, in the sense that if you look at the last box, our mix of clients is actually pretty evenly corporate and financial institutions. If you did this in most other banks, the financial institutions and government number would be 80-90%. They would be dealing with insurance companies, banks, hedge funds and governments. The corporate sector is unusual; probably if you did this for Citibank, it would have a similar set of numbers.

But that corporate base is incredibly sticky, and that corporate base is the piece that we've grown our market share in over the last two or three years as the large French and German banks have had to pull back, particularly from the emerging markets, and indeed we've grown it here in the UK as people like RBS have exited the Markets business as well. So, there's been a significant market share gain in this and that's why we have this rather unusual kind of client mix. So it's quite a differentiated wholesale banking business model, and should not be boxed with a Deutsche Bank, BarCap sort of model at all.

Our areas of focus, combined with our mix of clients, I think ensure we remain top-ranked in our chosen key products. The rankings – actually, with the footnotes as to where the rankings are from, are examples of the areas of focus, are in the grey box on the right-hand side, and show actually pretty dominant positions in the things that we've chosen to specialise in. So this is a business, actually, that has really now come of age. And again, before the financial crisis back in 2006, we kind of made $5-6 billion a year in this; we now make $9-10 billion in this, because we've basically now captured market share of customer business.

Now if I may, I can just give you a few Global Banking and Markets examples. What I would mention on these customer examples is all of these customers have given us permission and approval to use their data, which is also by definition a bit of an indication of the fact we do have really good relationships with them. So both the CMB clients and these guys have actually pre-approved us using these examples today. So each of these clients is a multinational, which we bank in between 20 and 29 different countries. All of them have headquarters in a developed country, but they have significant operations across the globe. Our global footprint means that we can provide support for these companies, both at headquarters and in the field. They are deep client partnerships that usually began decades ago and actually in the case of Glaxo, over a century ago. We look to provide banking services to these clients across a range of products and around the globe, as is the case in AES. Specifically, in Siemens, we have just developed an RMB trade settlement solution for them. We connect capital; for example, we were joint global coordinator and book runner for EDF's €6.2 billion hybrid bond issuance. In the case of both GlaxoSmithKline and, currently, Unilever, we're financing the increase of stake in their Indian subsidiary; Hindustan Unilever in the case of Unilever; and Glaxo's deal earlier on. The Unilever deal has a value of $5.4 billion. We're the only bank doing this. So this, again, shows our ability to connect both our operation in India; our operation in Hong Kong, where actually the equity capital markets guys sit; and clearly the coverage here in the UK. So, you can see in this, this is quite a unique business model and the linkage pieces are starting to produce, actually, quite significant advantage to the Group.

Now, let me turn to Retail Banking and Wealth Management. We're now targeting incremental wealth revenues of $3 billion by 2016. This is less than the original target, so let me explain why. We set $4 billion back in 2011. Actually, really what's happened is that the conduct risk agenda and the customer address risk has changed phenomenally in the meantime. So the conduct risk agenda of regulators, effectively looking back 10 years, and effectively looking at whether the banks explained all possible outcomes, means that the type of wealth management products you can sell has to change. Secondly, the compensation structures that we had in place for wealth advisors have already changed from the start of this year. So we no longer have any commissioned-based people selling wealth products anywhere. So therefore we think it is actually part of, frankly, our global standards in de-risking, to settle a more reasonable target for this opportunity. The opportunity is absolutely still there, but we think that actually, $3 billion is an achievable target that won't expose the firm to undue conduct risk, and therefore customer redress in due course

The return on risk-weighted assets of this business, excluding the run-off portfolios, is superb. What I would say, though, in answer to the question of, 'Why don't you put all of your risk-weighted assets into Retail Banking and Wealth Management', is the majority of the P&L is out of the UK and Hong Kong. So it is a narrow geography, with a sensational return. The fact is, you couldn't deploy all the surface capital into these businesses.

Then, also in RBWM, we're investing in our digital capabilities. Here you can see some examples of several new mobile and tablet tools. A new version of the mobile banking app was launched in Hong Kong, in the US, and for First Direct, so you can now trade stocks and FX in Hong Kong right now. They will be deployed across other markets throughout the year. We've also just taken on an individual from Google who will be joining us as Head of Digital for RBWM. Clearly, this is an area of expertise that we believe is best populated by an outside hire.

In addition, we've also started to create some innovation centres within the Group. Again, you would think that a large organisation like this is lacking on innovation, but of course again, if you flip it around the other way, within a community of 250,000 people, you actually are going to find some pretty bright, interesting people who are interested in this. Actually, therefore, we are being able better to identify that talent and bring it forward. So, there are some exciting things going on with this, which of course will also raise questions about our branch strategy going forward. The more there's an adoption of digital, smartphones, etc, the less likely we are to need the entire branch networks that we have everywhere. People won't be banking by going into branches; Commercial Banking clients will be going into corporate centres and, actually, individuals will be mostly conducting their banking through a smart device of some sort. That obviously has political difficulties in certain countries as you exit branches, but also has a significant cost saving opportunity. One of the things about a branch network, clearly, is that you have a substantial sum of fixed cost that sits around your branch network.

Lastly, let me turn to Private Banking, and the growth opportunities there. The Private Banking growth opportunities: it is very logical for us to have a private bank because we are sitting in places with fantastic wealth creation. But we clearly need to reform as, indeed, frankly, the industry does, the Private Banking model. Specifically at HSBC's level, we need to move ours to being much more aligned to HSBC's strengths and its values and global standards. So what I mean by that – and Peter Boyles is now running the Private Bank, and he's here and you can talk to him over lunch – is we are going to fix the focus of the Private Bank towards the mission statement that is actually at the top of this slide. This is actually important. So, the Private Bank in our view should really be sourcing its customers from our Commercial Banking business. Our Private Banking customers should be the entrepreneur who sets up his business, we finance his trade, we eventually list him on the Hong Kong Stock Exchange or the São Paulo Stock Exchange, and that wealth event creates the private banking opportunity. You know the customer; your AML, your KYC has been in place for years and years and years. You want to capture that value chain. Therefore, we need to make some changes to our current Private Banking portfolio, because the piece that we have in Hong Kong and Singapore and in London and in Miami, and actually in New York, fits that. The piece in Switzerland, which was the Republic National Bank of New York piece, does not necessarily fit that. So therefore there will be work here, but the key point is, this is an important business; this has a reasonably high return on risk-weighted assets. We will stay in Private Banking, but we will need to change the shape of our Private Banking business, so it's absolutely lockstep with the rest of HSBC.

Now, I want to turn to the second priority, which is implementing global standards. I actually believe that implementing global standards in the medium-term will give us a distinct competitive advantage. You can see this as a significant increase in the cost-base, which it is; and a significant exit of certain revenue streams, which it also is. But actually, those revenue streams and that cost base is preventing you having the size of customer redress and the size of fines that we, as a firm, have run into over the last several years.

So, on the one hand, we probably have increased our run-rate costs by $700-800 million for compliance; and we estimate there is probably $800 million of revenue that we will forgo as we exit certain activities.

But we paid $4.3 billion last year in customer redress and fines. So this is improving the quality of the PBT of HSBC. I think it's very important that you're aware of why we're doing this.

So, let me tell you how we're approaching this. Yes, we've set out, as I said earlier, the purpose of the firm. This is very much integrated; this is not a separate project to the day-to-day running of the Bank. We define the clear values of the firm. About 5,000 people have gone through values workshops, most of which were taught by Harvard Business School. Actually, last year, we exited nearly 600 people from the organisation for values-related breaches. So this is real. This is actually how we are managing the firm. I think we have also been very successful at attracting and retaining talent.

We've also put in place a significant structure of governance, and let me provide you with some detail, therefore, as to how global standards is executed. At the Board level, Douglas has created the Financial Systems Vulnerability Committee, which is a new Board committee of independent advisors, which provides governance, oversight and policy advice. This is populated, actually, by some of the leading figures, frankly, from law enforcement, which is clearly where we need to get to, to future-proof HSBC from what's likely to be the next threat. It may not be money laundering from drug cartels; it may be cyber terrorism or something similar.

We set up a Global Standards Steering Committee, which is part of the Group Management Board, which is basically the most senior committee that I chair that runs the firm, and sets the strategic directions of priority. There's in essence, then, some execution committee where the rubber hits the road. Then there's at least three significant programmes which we're running, on customer due diligence, financial crime and financial intelligence, to better improve the situation that HSBC finds itself in. We operate in a complex set of countries, so therefore we have to do this so that we can actually be on top of the risks that come to us as we drive this forward.

This has also resulted in terms of changes to the day-to-day activities. I said a moment ago, we are actually completely in our wealth management business moved away from commission structures; we are requiring higher qualifications from people; and we've absolutely now started a process of driving through review of all products to make sure they are fit-for-purpose and don't expose us to vulnerability.

So, now I'm going to pass the presentation to Sean, who will address the third big priority, which is streamlining the processes and procedures.

Sean O'Sullivan, Group Chief Operating Officer

Thanks Stuart, and good morning everyone. So, Stuart mentioned before that we've generated $4 billion of sustainable cost-saves on an annualised basis, across the four programmes since the middle of 2011. So, how have we done it?

Well, we have successfully implemented a number of initiatives including people and structure, which has involved the restructuring of the Group, as Stuart mentioned before, into the four global businesses and the 11 functions. So far, we have implemented the 8x8 de-layering exercise across 54 markets across the Group. Our de-layering initiative has made a significant contribution to the sustainable saves objective. We're on track to exceed more than $1 billion of saves, and reduce headcount by 10,000 as a result of this initiative.

Software development, where we have reduced overall software development headcount by 11%, increased the proportion of IT developers in low-cost locations from 47% to 54%, and increased our overall development productivity by 8%. So, simply put, that means that we are creating more lines of software code, with fewer people, at a lower average cost.

Now, Stuart mentioned before that we're investing a lot in digital. We've increased significantly that investment over the past 18 months. At the start of that journey, we asked ourselves, 'Frankly, do we have the capabilities to deliver efficiently and effectively?' The answer, to be honest, was no, not the way we were structured. We had our capabilities dispersed all around the world. So what we have done is we've put our key resources, our key engineering resources for digital into three optimal locations around the Group and we are supplementing our capabilities with external firms with an expertise in the field.

Look at process optimisation, where we have started to introduce production management tools, and also progressed end-to-end process engineering initiatives in areas such as trade, call centres, and payments areas; we have generated $300 million in sustainable saves, almost, from that area. Implementing consistent business models: where we have implemented globally consistent productivity metrics in RBWM, and CMB, that has allowed us to reduce headcount by almost 3,000 as a result of that initiative, in addition to what those businesses have achieved through the people and structure initiative.

Corporate real estate portfolio rationalisation: here, we have reduced our overall business-as-usual ongoing square foot requirements by 3.5 million square feet. So to put that in perspective, we have basically reduced three times the size of this building. We have done it due to the headcount reductions, and also by implementing consolidation, workplace activities, etc.

Now, a significant amount of the sustainable saves have come from a holistic review of our external spend. As you can imagine, we spend a lot of money externally. We've implemented tighter management control over external vendors, and we have taken a deep review of how we spend our money, and what we spend it on. So, so far, we've delivered more than $450 million of sustainable saves as a result of this initiative. I should point out that some of those numbers are included in the numbers you see on the slide.

Now, if you look at what we've achieved, we have put in place the global structure. So we have moved from a fragmented business to a cohesive portfolio of businesses; from a complex and inconsistent management structure, to a consistent, streamlined structure across the Group; from a federated and functional business model, to a global model. However, while we have changed the management structure, and we've implemented and basically designed the target operating models, there's just a huge amount of opportunity to simplify, streamline and globalise the on-the-ground processes and practices that go on across the Group.

So, let me give you a few examples of that. Around the Group, we produce more than 4,000 management information reports; a significant number would have overlapping info in them and it takes tons of people to manually intervene to get the work done. We currently spend $500 million a year on 1,100 vendors who provide facilities management services, such as cleaning and maintenance. In terms of globalising, we have 57 different versions of personal internet banking; before, we had 46 versions of business internet banking, until we happily retired 12 of them over the past year. There are multiple ways of opening up a corporate account across HSBC, and the unit-cost variance between the best country and the worst country is more than 13 times. I could go on and on, but I hope you see the opportunity.

Now, as Stuart mentioned before, the banking industry is not unique in having to respond to transformational changes in its operating environment. You look at other industries, as you can see on the slide – telecoms, automotive, etc – they have faced similar shocks and have had to restore profitability through rigorous cost discipline and productivity improvements. So we at HSBC are leveraging front-to-back industrial engineering methodologies, deployed successfully in these other industries, to simplify, streamline and globalise our processes to reduce cost, but also make it easier to do business for our customers and for our colleagues.

I've challenged our COOs across HSBC to start to think more like Vice Presidents of manufacturing. Our Head of Operations is an industrial engineer; his first job was in a plastics manufacturing company. Let me give you an example, and it's mortgage process globalisation, which we started in the UK. We completely re-designed the mortgage process, leveraging customer insight, technology and business process engineering. We've delivered live underwriting, enabling referred customers to get an instant credit decision, whether it be in the branch or on the phone. We've provided an online application and switcher process which has supported incremental lending of over $1 billion. We've created a modern, efficient and effective back office; way less paper than we had before. So what's the result? The result has been the customer experience has significantly improved. Back office costs are down by 30%, notwithstanding the fact that we've increased new business volumes by 25%. This has enabled us in the UK to increase our market share in mortgages from 2% to 12%, and more than double our mortgage income since 2007. In China now, we're leveraging the UK experience and we expect to roll this out to other priority markets such as Brazil and France in 2013 and beyond.

Now, our plan is to streamline, globalise and simplify our operational practices and processes to generate a further $2-3 billion in sustainable saves between 2014 and 2016. So, to clarify, we're planning incremental, sustainable saves during 2013 that get us to $4 billion on a P&L basis by the end of the year. Now, some of you have annualised that and basically taken it to, you know, $4.5-4.6 billion, and that's probably reasonably accurate, so $4 billion on a P&L basis by the end of 2013, plus an incremental $2-3 billion, that's with a top end, as Stuart said, $7 billion. Now, over the medium term, we anticipate our overall headcount as a firm, based on our current business scope, would gradually bottom out between 240,000 and 250,000, because we'll be re-investing our sustainable savings to support investment in organic growth, and investment in the global standards initiative. So, to clarify on that, again: that 240-250 number is an estimate considering the medium-term impact of known disposals, estimated role reductions and investments in new roles, okay?

We have a robust pipeline to take us and hopefully achieve the next target, so let me provide a few examples. I mentioned management information before, through an initiative called 'MI simplification' we're implementing a standard finance operating model across the Group to centralise, standardise and rationalise MI production and deliver $75 million of sustainable saves. We've recently signed a five year facilities management contract with one vendor, which is replacing 1,100 suppliers, will save us $50 million a year and take out a whole bunch of complexity.

The United States is a key part of our transformation. Stuart has spoken about our plans to grow revenue in the US. Let me speak about our plans regarding the infrastructure. In this area, we have three key strategic priorities.

One: remediate the identified control deficiencies, and improve the risk management infrastructure. Create an improved compliance infrastructure that consistently meets regulatory expectations. Two: Disposals and rundown. Manage the transitional service agreements to conclusion. Progress the CML business rundown with responsible, ethical collections and customer service. Potentially accelerate the wind-down through the portfolio sales as market conditions improve. And finally, three: core bank business engineering. We are executing a transformation plan in the US focused on streamlining and simplifying our IT environment, operations environment and the global functions. At the same time, we intend to enhance our risk and compliance areas, and improve efficiency and effectiveness. The plan also involves the replacement of our overly-complex systems environment in the US with the Group's Core Banking platform.
So, if you look at the US in terms of the infrastructure, core bank re-engineering, TSA exits and portfolio reductions should enable us to reduce US costs by roughly $800 million between now and 2016, and reduce our cost-efficiency ratio in the US to the mid-60s, which is comparable to other banks in the USA.

Now, in terms of globalising, we've got a number of initiatives focused on standardising the way we do things. So we're implementing a number of front-to-back RBWM re-engineering programmes, which are expected to generate a further $500 million in sustainable cost saves between 2014 and 2016. So, for example, we're going to deploy the re-engineering approach that I mentioned before with respect to mortgages to other products such as personal lending and wealth products. We're deploying scanning and imaging technology and leveraging the digital enhancements that we talked about before to improve straight-through processing for our customers, and for our back offices, and that'll help us reduce paper. And by the way, just for your information: last year alone at HSBC we reduced our paper consumption, excluding the impact of disposals, by more than 20%. More to do.

We're deploying global standards in areas such as customer due diligence and payment screening, to enhance the consistency of our customer offerings, improve our overall financial crime compliance and increase efficiency. I don't see the global standards initiative as being inconsistent with improving the operational capability of the company. I see it absolutely aligned.

And finally, in 2012 we spent about $1 billion managing documents, cash and cheques in multiple different ways across the Group. We're implementing a globally consistent approach to managing these activities as we speak, and we expect to generate $100 million in sustainable cost saves from doing that between now and 2015.

So, in summary, we've exceeded the sustainable saves target of between $2.5-3.5 billion, but there is a significant opportunity for us to do more. We've got a robust plan to deliver it, and some really good initiatives to back up the plan. Thanks very much, and I'll pass it now over to Iain to talk about the financial targets.

Iain Mackay, Group Finance Director

A few key things here: in 2011 and 2012 we committed to targets around capital and liquidity and the profitability and cost efficiency of the firm. There's absolutely no change in that regard. That's what we're going to do for the remainder of 2013, and 2014 through 2016 as well. We have made a couple of changes to this, so I'll briefly cover these just now and then we'll go into a bit more detail on each of the key metrics here.

First change, around the cost-efficiency ratio. We've altered the emphasis here to one of positive jaws as opposed to an absolute range around the cost-efficiency ratio. This is really to strike a more appropriate balance around the need to recognise changes within the environment from an economic standpoint, from a revenue standpoint, which are somewhat out of our control, while maintaining a clear discipline in cost management, and the need to continue to invest in the core capabilities and the growth of the business. And from our experience, certainly over the last couple of years of working through this, maintaining a positive jaws, growing revenues at a rate faster than that at which we'd grow costs, clearly continues to move us progressively towards a better cost-efficiency ratio than we've certainly experienced over the last couple of years, and we saw improvement in that in the first quarter of this year, but we'll continue that momentum of moving the cost-efficiency ratio in the right direction over 2014-16. So this is the first key change; now, that being said, we're not going to abandon the cost-efficiency ratio. This is something that we monitor very closely, and setting out a range that strikes middle 50s – and I'm sure I'll get lots of questions about what does middle 50s mean? It means middle 50s, so, if you keep asking the question, that's the answer you're going to get. I'm just trying to keep this short. So from that standpoint, the positive jaws will move us to a better cost-efficiency ratio over time, whilst at the same time striking that balance. This doesn't mean we're de-emphasising cost discipline. As Sean just said, $2-3 billion more of sustainable saves over the next few years; the pipeline around our propensity to do that is strong, and I think what we've demonstrated over the last couple of years is our ability to deliver against that.
So, positive jaws and continue to keep a close eye on monitoring where we are from a cost-efficiency ratio perspective.

Second change we'll talk about is really just a fairly subtle change in the capital ratio, the Common Equity tier 1 ratio for the firm, where we move this to be greater than 10% over the coming few years. I think what we see is that we've got a better understanding of where we need to be from a Basel III perspective, against CRDIV. The final technical guidance around that is not complete yet; we should hopefully have that at the beginning of the second half of this year, but based on what we understand, and really everything that we talk about here in capital is informed by, really, the version of CRDIV that came out in July of 2011, and any further clarifications we've got from working with the PRA. But greater than 10% puts us in a well-capitalised position, and certainly when you see where we were at the end of the first quarter, taking into account the management actions, based on our current understanding of the roles, we're in good shape against that. I think that positions us as a very strongly capitalised institution, and then when you reflect on our capital generative ability, it gives us propensity to take actions in certain other areas.

Taking these factors into consideration, we keep the return on equity very much focused on 12-15%.

Thinking about the efficiency aspect of this now, the cost efficiency. We've clearly demonstrated our ability to drive sustainable saves. There's been great execution around a lengthy pipeline of projects that's delivered annualised costs savings of nearly $4 billion, but what we talked about at the beginning of 2011, really, if you like, the origins of the need to drive that sustainable saves, was to create capacity to invest in our businesses, around the operating capabilities, the growth of the businesses, and to deal with headwinds from the ever-present inflation across the many markets in which we operate. In 2012, we invested much of the sustainable saves that were generated in that year; investment in compliance and infrastructure, and investment in growth. Over the course of that, we invested about $1.3 billion in growth infrastructure and compliance programmes. Really, from a compliance investments perspective, our focus was primarily in the US and in Mexico, but it also supported the launch of our global standards programme globally. In terms of other projects where we saw investment, it was around addressing real estate streamlining and other infrastructure projects, and Sean has highlighted some of those, and those were primarily orientated in US, Europe and Asia. In terms of supporting the re-shaping of the portfolio, there was significant investment around developing transition support agreements, the most significant perhaps of which was transitioning the ownership of our cards and retail services businesses to Capital One; which is a two-year commitment, which we're now half-way through and on line to complete. But there was a significant investment in these TSA programmes, and we have more than a couple of hundred of these agreements in place, and the investment associated with it, ensuring that these transitions are conducted efficiently, effectively and completed, is an important part of what we've invested effort and resources in.

Another aspect which Stuart touched on earlier was making sure that where we do acquisitions that we get the integration right first time, and get it right quickly, and not an insignificant amount of resources were focused on two relatively small acquisitions and mergers that we did in the Middle East and North Africa during 2012. I think the other thing to take away from this, and we've talked about it, is 2012 was significantly impacted by the fines and penalties that we incurred over the course of the year, as well as customer redress, mainly in the United Kingdom. So the construct around driving sustainable saves hasn't really changed. It is about funding the capacity for growth within the business, it is about dealing with inflationary headwinds, and it's about creating the operational capacities and capabilities that we need within this firm going forward.

A little bit more around the balance on positive jaws here, and why we think this is a sensible transition. This is largely informed by what we've learned over the course of the last two years, again about striking the right balance between investing in the capabilities of our businesses whilst maintaining a very strong discipline within the firm. And I think this comes down to an operational level, and it's very easy for people to grasp, that if we're having challenges in any of our markets around the world in growing and driving growth within the business, then we need to have a reflex on the costs within the business. You can't just simply go 'My goodness, we're not getting growth out of this,' without looking at the overall profitability equation and addressing costs in a serious manner, and that's what jaws really enshrines. Revenue growth; cost growth at a slower rate than that. But what this also gives us is flexibility to respond to on-going macroeconomic changes and, frankly changes in the regulatory environment as well. It would be an understatement if I said we'd invested significant amounts of money in meeting simply the requirements of regulatory change, regulatory reporting, across the risk and finance functions over the course of the last couple of years. It certainly allows us to strike the right balance from an investment perspective, in ensuring that we do make the right allocation decisions around investing in the growth of our businesses.

It certainly, I think, from our perspective, means that we can maintain consistency around, if you like, an operating metric that everybody can understand, that's pretty easy, and with which we can clearly measure our progress over the next few years. I think what's equally obvious is that the positive jaws is not necessarily something that you can do in perpetuity. To suggest that we get to a cost-efficiency ratio of the firm overall of 30% isn't realistic, but this is something that, certainly for the next few years, I think, helps us strike the balance around the challenges that I've talked about, but also to continue to instil within the workforce as a whole the discipline that we need and the responsiveness that we need around managing the cost base in line with economic activity.

So this is the important change; I think it's something that we've been talking about for some time, but it is certainly something that we'll give greater emphasis to from a measurement perspective, and we will as a guideline keep a focus on what's going on from a cost efficiency perspective overall, with a goal of getting it into and maintaining it in the mid-50s.

What's the main thing perhaps to take away from this page? This is just a cut of our 2012 results. We have inadvertently injected a little bit of humour into how many different ways we can describe the operating results of HSBC, but at the risk of boring you we're going to stick with a slide that we actually used last year as well. This really takes 2012 and again reflects on the impact on profitability and returns of the run-off and legacy portfolios within the CML sub-prime portfolio in the US, and the legacy ABS portfolio within Global Banking and Markets, the impact of disposals on profitability, as well as outlining the impact of what we've called the notable items, on which we've given you significant detail over the last number of quarters. When you reflect on that from a return on risk-weighted assets perspective about that part of the business on which we focus the growth investment, and our energies around growing this business, we're generating a return on risk-weighted assets in the range of 2.3% for the Group. And I'll take you through over the course of the next couple of pages on what that really means in terms of global businesses and the main operating regions that we've got round the world, but this really just breaks down some of the key components of what drives and what informs how we've established targets around the return on risk-weighted assets and how we monitor it within the Group.

Talking about this from a global business perspective, you know, you reflect on Stuart's remarks in terms of organic investment and oversight by the Group Management Board, and the allocation of risk-weighted assets and capital subsidiaries and operating regions focused on delivering growth and returns to the shareholders through the global businesses and regions. When you reflect on this at an operating level, if you like, the main set of targets that we've got out there for our teams around the world in the global businesses is a return on risk-weighted assets. The targets are based on and developed through an analysis of the capital requirements that we've got, the profit generating and the profitability capability of our global businesses, and clearly triangulated around achieving a return on equity for the Group within the 12-15% range. All of these targets are informed from a capital perspective by endpoint CRDIV. So this is not transitionally, this is not 2.5; this is end-point CRDIV, on a fully loaded basis. I think one of the things you will note here is that we haven't included a target for the Global Private Bank, principally because we have very little risk-weighted assets sitting within the Global Private Bank. It's not really a credit and lending business, and therefore in terms of return on risk-weighted assets it's not really relevant from a Group perspective overall, and as we mentioned earlier probably a return on client assets is a better way to reflect on that. So we haven't really challenged the Global Private Bank in this regard.

Again, going back to how these targets are informed, it's against the capital requirements; the common equity tier-1 requirements under our CRDIV construct. However, I think what we've also got to realise, the clear relationship is that we still face somewhat of a moving feast from a regulatory capital standpoint. We've based these targets driven off greater than 10% Common Equity tier 1. However, were you to see a requirement from a regulatory standpoint where perhaps Common Equity tier 1 needed to be at 12% or slightly greater than that, then clearly our businesses would need to be delivering at the top end of these ranges, and in some circumstances even beyond that to deliver at the 12-15% return on equity that we've targeted.

The main point I'm trying to get across here is that the relationship, although we drive this from a return on risk-weighted assets perspective at an operational level, the relevance of these targets will possibly change over time as the capital construct of the Group changes over time, and clearly will be informed by the rate of investment that we're capable of driving, as well as the distribution-to-shareholder decisions that we will make over time. I think the clear thing to bear in mind here is that the actions that we've outlined today will move our business returns into the ranges that we've described here, and I think another key factor, and one of the things that influences these ranges, is that the effect of our legacy and run-off portfolios will continue to be managed down quite aggressively within Retail Banking and Wealth Management and Global Banking and Markets.

This is really the same thing by our operating regions, so there's no wonderful magic around this. Clearly the composition of this is made up of the relative composition of each of the four global businesses within the operating regions, as well as, obviously, the economic factors that are driving the different performances within these regions. You will notice one or two changes within this when compared to some of the targets that we laid out in previous years. As one small example, if you reflect on the change in Asia, this is largely informed by the fact that we disposed of Ping An. That was a high return on risk-weighted asset business, principally because there weren't a lot of risk-weighted assets coming through that, and really only latterly were we picking up risk-weighted assets as Ping An had invested in the Shenzhen Development Bank, and through regulatory consolidation we picked up some of those banking risk-weighted assets. If you reflect on the US improvements, it's principally informed by the run-off – and the successful run-off – and the improving performance of the CML portfolio. And it's really some of the subtleties around that and the prevailing economic conditions, as well as changes in capital construct, that have informed these targets, but they remain largely consistent with what we talked about in previous periods.

Moving on to capital strength, I think probably the main thing to take away from this chart is against the greater than 10% Common Equity tier 1 target, at the end of the first quarter, taking into consideration the management actions executed and anticipated based on our understanding of CRDIV at this point in time, we've achieved this target. This is something that is, as I mentioned, a little bit of a moving feast. There continues to be fair bit of regulatory uncertainty. CRDIV finalisation will help enormously, and then I think as the UK authorities in particular get their arms around how they intend to interpret and apply this, we'll learn more. But there is clearly a pathway that we've largely executed against here in terms of delivering compliance against CRDIV capital requirements, but we'll continue to monitor this and keep you posted as we move through it.

Some of that uncertainty. This is possibly up there for the prize as one of the busiest slides that we've got in the deck, and is probably a pretty good analogue for the fact that the regulatory framework and the regulatory scenery is probably one of the busiest things that's going on around us at the moment. This really just lays out some of the uncertainties that we face. We'll get clarity around CRDIV to a significant degree later this year, one hopes, and suspect we'll be implementing that within the European zone from 1 January next year. The level of national discretion that CRDIV offers is quite significant around counter-cyclical buffers, domestic SIFI buffers, global SIFI buffers, sectoral buffers, as an example; very difficult to say how the PRA will necessarily interpret that and apply it. Perhaps some of the pronouncements from the FPC over the course of the last six months helps inform that, but I think this is an area where, again, hopefully over the next 6-12 months we'll get much greater clarity.

Another area that's out there which again remains very uncertain at present is structural reform, principally within the UK but not uniquely the case as the Europeans continue to challenge with this as well, and it possibly becomes increasingly an element of the debate within the United States also. The uncertainties are there, but I think again the key point that I'd make is very strong progression with the capital generation that we've got from the operations of the Group, the re-shaping transactions that have taken place over the course of the last two years, to put us in a strongly capitalised position, and certainly when we continue to focus on investing in the businesses, managing down the run-off and legacy portfolios, it certainly, I think, would be fair to say that we're very confident of being able to meet in a fairly comfortable fashion the requirements of regulatory change in this regard, and of the capacity to grow the businesses and grow the dividends in the form of a greater share for the shareholders.

Talking about the earnings split, this is just a quick recap of what Stuart talked about, if you like the mechanism in terms of investing, in terms of risk-weighted asset capacity, capital and investment in capability of the regions, the global businesses within those regions, but the constraints under which we've operated for many, many years is that the dividends, you know, after self-capitalisation and meeting local regulatory requirements, dividends come back to the parent company. They come back to Holdings plc, and the decisions are made there around investment and around distribution to shareholders, clearly under delegated authority from the Holdings Board for the Group. But this just lays out the mechanisms that will continue to operate and really the shape of how we see that earnings split progress over the coming years.

Now, in a financial sense, if I had to present one slide, this would probably be it. This is really what it all boils down to: that the capital-generative ability of the Group has remained strong over the last two years. In terms of what we can see out there and what can we can control, we believe this will continue to be the case. We continue to focus on the run-off and management of our legacy portfolios, but really what this is about is deploying capital. It's about deploying capital in two key areas: a clear focus on putting capital capacity, risk-weighted assets, and investment in terms of capabilities in our businesses, around driving organic growth. That's what the business is here to do. It's aligned to the strategy; it's got to be consistent with our risk appetite, and it's got to be value-accretive for the Group. That's the first priority for us as a Group in terms of deploying capital capacity. When you move beyond that, a secondary item – not an and/or but an and – is increasing the share for shareholders, principally through increasing the dividend pay-outs, with a focus on the higher end of the range around the dividend pay-out ratio. Again, we've made progress on that over the course of the last couple of years, and conditions permitting we will absolutely continue to do so over the coming years. To add a higher degree of optionality and create a few alternatives here, we've done a good deal of work in discussion with the regulators as well as with the Board about creating the capacity to do buybacks. This has got to be at the right time, and under the right conditions, as much for the shareholders as for, if you like, a reflection on any regulatory constraints that we may have. So I think clearly moving towards this, certainly no earlier than 2014 but hopefully being able to launch this in 2014, with the right sign-off from our regulators, which, again, with capital strength is not necessarily something that I think will be a significant obstacle; but also ensuring that the shareholders provide the approval for us to do so is something that we'll consider when the conditions are right, and I would say the sooner we can do that the better, but it's unlikely before 2014.

So, to be clear, our focus is on investing in global businesses. That's what it's about, but it's also about increasing returns to shareholders. With that, I'll hand it back to Stuart.

Stuart Gulliver

Okay, so let me just recap, and also formulate how I think the Group looks by 2016. So, as Iain has said, first priority is organic growth; investments that are aligned to the strategy; consistent with our risk appetite; value accretive for the Group. So by the end of 2016, we see a Group in which CMB will represent 30-40% of total PBT; RBWM and GBM 25-35% each; and the private bank less than 5%. The money will be made in the following geographies: so, you'll recall we defined the two home and 20 priority markets. By 2016, those home and priority markets will contribute 90-95% of Group PBT, and if you look on the *y* axis, the faster-growing regions will contribute 70-80% of Group PBT. So, prior slide sets out what we see the mix as being by global business; this slide sets out where the mix will be by geography, and then split between obviously the developed world and the emerging markets.

So, just to recap, and let me close by recapping: I think we're not even halfway through unlocking the value within HSBC. Our strategy does remain unchanged, because we think it's working. We have focus, and we have management grip. There are three priorities going forward: grow both the business and dividends; implement global standards; streamline our processes and procedures. And we're setting the following targets: an RoE of 12-15%; cost efficiency ratio of mid-50s with positive jaws; an additional $2-3 billion sustainable saves – lest anyone think the focus is coming off the costs, it's not – a Common Equity tier-1 ratio of at least 10%; the AD ratio cap unchanged at 90, and progressive dividends and share buybacks, as Iain has said, subject to regulatory approval and shareholder approval.

We're now very happy to take questions; what we've got in terms of time is an hour put aside for questions, and then actually when we finish questions you're then more than welcome to stay and have lunch with us or at the very least mingle with the Group Management Board, because all of the senior executives are actually in the audience.

Questions and answers

Manus Costello, Autonomous

Can I just ask for a couple of points of clarity? On the capital return to shareholders, should we regard the scrip neutralisation as business as usual going forward and share buybacks as being incremental to that, or are you using share buybacks to include scrip neutralisation?

Stuart Gulliver

I think it's the second, but clearly this doesn't start until 2014 because we're talking about 2014-16 and it clearly is subject to PRA approval and shareholder approval. But we would need to on each case look at the macro backdrop, but I think what you should see it as is a general move towards considering share buybacks within which the scrip dividend is part of it.

Manus Costello

Thanks, and just secondly if I look at your slides on potential revenue growth in the regions, and I look at your allocation of capital and your allocation of RWA growth matrix, it looks to me like you're still targeting potentially 8-9% top line growth. Is that about right as what you think the run rate would be given the markets you're in? And, sorry, just to follow-up on that, would that also be a rate for RWA?

Stuart Gulliver

I mean, the capital generation supports RWA growth of that type of number. Clearly it may not be the case that GDP growth supports that type of number, and yes, that is what's implied within that deployment. That's the key variable. If we continue to have GDP growth that's flattened out by OE, then we won't get those RWAs to work, and that therefore gets solved in terms of dividend. But yeah, that is what sits under those numbers.

Manus Costello

Thank you.

Tom Rayner, Exane BNP Paribas

Two questions, please, the first on the cost/income target, and the second on the scrip dividend, please. Just really struggling a little bit to understand why you have set a cost/income target in the mid-50s. Obviously there's a lot more cost-savings coming through, you're increasing the savings every time you report to us, and it seems to suggest that if revenue were to recover, your target would imply you have to ramp up investment to an extent, or perhaps it seems to suggest that you don't have much confidence you are going to see any revenue growth going forward, because with the sort of cost savings you would have thought the cost outlook looked fairly flat; so, I just wondered if you could maybe explain that a little bit more, and then I have second, please, on the scrip.

Iain Mackay

No, good question, Tom. I'll go back to my comments: this is about trying to strike the right balance between recognising, if you like, the ground moving below your feet from a macro-economic background, and that's market by market. We're operating in 80 markets around the world, many of which offer fairly attractive growth opportunities but nonetheless in a competitive environment, whilst at the same time recognising that we have continued investment to do around deploying global standards, around business capabilities, some of the things that both Stuart and Sean had talked about earlier this morning, and balancing that with discipline from a cost management standpoint. So the key focus here is driving positive jaws. The CER is clearly an important one: mid-50s is mid-50s – don't read too much into it.

Stuart Gulliver

Yes, and don't use 55 and back-solve for revenue reduction. It's set at mid-50s to mean mid-50s, as opposed to meaning 55, because if we'd meant 55 we'd have said 55.

Iain Mackay

The operating metric around positive jaws is to drive the right discipline while creating flexibility around the balance of macro-economic change and investment requirements.

Tom Rayner

Okay, thank you. That's very clear. Just on the second question, the pie chart on slide 19 and repeated on slide 75 seems to very strongly say that dividends will only be paid out of the free cash flow that you generate in a specific year, so you're always going to retain enough earnings to fund the RWA growth. So it does look as if share buybacks is the only tool that you're giving yourselves to manage any surplus capital, and I just wondered if you could comment on what your strategy will be, how you will time that, what sort of size do you think will be possible, does the share price at the time matter? I just wonder if you could add a bit of colour, please, to buybacks?

Iain Mackay

If I go back to dividends to start with, again, that's a representation. It's not intended to take any particular given year's earnings and just divvy it up with that degree of rigidity. What we distribute dividends out of is distributable reserve, and within the organisation we maintain very robust distributable reserves. The propensity to increase the dividend will be determined, one, by the profitability of the organisation and the line of sight to continue profitability of the organisation; two, the regulatory framework and developing certainty around that over the coming months; and, three, the desire to drive growth in the dividends, but we shouldn't necessarily view this in the construct of restrictions in the profitability within any given year, recognising that dividends are distributed from distributable reserves, which are very healthy within the Group.

Michael Helsby

Two questions if I can, firstly on the US. I don't know if I'm the only one, but when I get to that section of the model, and when you go through the Retail and the GBM and the Commercial, I just completely get lost.

I was wondering if you could give us an update on how you think about it – because you haven't really talked about the US from a revenue point of view. You touched on it and costs, and what the AML sanctions have done in terms of execution of your strategy. So if you just touch on that strategy, and particularly from a revenue point of view, in both the Retail, Commercial and in GBM, that would be great.

Stuart Gulliver

Okay, so look, in the US we have clearly a legacy business, Household, which is in rundown. That legacy business has a residual book, which we gave some detail on in one of the slides, which we think will be down to $20 billion by 2016. Separately, there has always been a bank in the United States, and clearly that is the focused business going forward. Between transitioning the rundown of the consumer finance business and bringing the bank back up, we have an infrastructure that is outsized for the bank, because the infrastructure existed to support a very big consumer finance business and a bank. That's what Sean's talking about when he says that Irene and the team will take $800 million out of the US cost base over this three year period. A chunk of that comes from reduction in the amount of consultancy that we're using in order to deal with the cease and desist orders; a chunk of that comes from effectively running down the Household business. Then, some of it comes from the sustainable saves activities that are outlined, so of the $800 million, $400 million of it is part of – $400 million of it goes into the sustainable saves target of $2-3 billion; $400 of it represents the end of TSAs, the end of consultancy – you know, the transition of the business.

From a revenue point of view, the focus effectively will be on Commercial Banking and on Global Banking and Markets. The commercial banking piece is effectively a build, and that build is taking place primarily in different parts of the United States in the historical Marine Midland territory. The historical Marine Midland territory is the north-east, and up in New York State, which clearly does not have huge revenue growth, so therefore there's a build-out on the west coast, which is clearly Pacific trade across to Asia-Pacific, and there's a build-out in the oil and gas sectors, and actually that business will be very much about the renaissance of the manufacturing industry in the United States, which we think will take place because of cheap oil and gas with what's going on in Dakota.

The Global Banking and Markets business has been consistently profitable for a number of years, and that business really reflects a cross-border strategy which is about bringing Asia-Pacific, Middle East, European issuers to US investors, and vice versa, and is a leg of our global foreign exchange business, which remains a very profitable business. So what you get in the US over the next three years is a significant reduction in cost as we shrink and outsized infrastructure to fit effectively what will be a Global Banking and Markets and Commercial Banking business. There is a Retail Banking strategy that really sits around premier, mass affluent, but provides significant funding through the branch network and through the deposit base for the loan book of CMB and Global Banking and Markets. But if you look at where the P&L will come from, it's probably likely to be 50% from Global Banking and Markets; probably 30% from CMB and 20% from Retail Banking and Wealth Management – Retail Banking and Wealth Management in this construct being the conventional Retail Banking Wealth and Management you'd get from a bank, as opposed to the consumer finance business, which is absolutely in rundown.

Michael Helsby

Thanks. I've got a second question. Just before I move on to that I notice from your targets a sort of reverse-out of your return on risk-weighted assets for 2016; it's about an 8% RoE if I take the mid-range. Is that because of the dilution from the consumer finance book, and if it is, what would it be ex-that?

Iain Mackay

Run me through that one again, Michael.

Iain Mackay

No, it is. You're in the right space, yes.

Michael Helsby

Okay, but is it… So it's just the consumer finance book.

Iain Mackay

That's the principal driver, yes.

Stuart Gulliver

So, if you didn't have those, it would hit the target.

Michael Helsby

Okay, and then just finally, if I remember, back in May 2011, you were cautioning us at the time about taking the current rate of impairments outside of the US and thinking about those going forward when you hit your RoE target, and it was all very revenue driven, obviously, with cost containment. Clearly since then the bad debt has improved quite dramatically, so I was wondering if you could share with us what your thoughts are today on that outlook and how you think of that from a return on risk-weighted assets perspective.

Stuart Gulliver

I'll start, and I think Iain can jump in on this. Look, we've actually spent a lot of time in the last two and a half years de-risking the firm, so we very consciously have run down the ABS book, very consciously run down the Household book, and very consciously switched from clean lending to secure lending in our RBWM businesses around the world, and our CMB business around the world. So the big growth in CMB is trade, which effectively is self-liquidating. We've actually, unlike some of our competitors, consciously de-risked the firm over this period of time. So, loan impairment charges aren't something that just happen to us; they're actually an output of a series of quite precise management actions that have taken place, so one has to, clearly, remain cautious on your loan impairment charges, but there is nothing that we see at the moment beyond the cyclical uptrend that undoubtedly will happen during any business cycle, there's not a specific idiosyncratic risk that will affect the collectives, and on the idiosyncratic, you know, that is kind of case-by-case, but there's nothing we're looking at at the moment that would give us undue cause for concern.

Iain Mackay

I think if you reflect specifically on the US, Michael, Irene, and Pat Burke who manages the CML rundown are both here, so they'll jump in if there's more to add here, but there's been, I think, an incredibly robust focus and success in terms of managing down the CML portfolio over the last few years. This nascent and sort of creeping along economic recovery, if that's what we can call it in the US, which is beginning to show up in some improvement in property market prices, improving employment is probably the biggest factor impacting performance in our book. All of those factors bode reasonably well for continued stability, and as we continue to run down this book, clearly the quantum of loan impairment charges should continue to improve, but I think it's very fair to say we have seen some very substantial, if you like, step function changes in that over the course of the last 18 months. I wouldn't read a great deal more in terms of seeing the same magnitude of step functions; there's a rhythm that needs to come through this book, it's affected to some degree by continually prolonged foreclosure cycles, which impacts to a certain degree performance, but as long as we keep seeing this creeping-along improvement in the unemployment rates and property prices in the US, and nothing crazy blows up in Washington D.C. from a Federal government perspective, then I think we've got a reasonably steady ship to look at. Would that be a fair statement?

Stuart Gulliver

Also, bear in mind that we sold the card business, so there's a step jump impact in terms of the number. The card business is not in there anymore. Can we go to this side of the room?

Raul Sinha, JP Morgan

Can I have two to start with? Firstly, one of the ways you could use up excess capital would be to accelerate the run-off of non-core assets, and obviously you've said you want to keep things on a capital accretive basis. Even if it is not capital accretive in terms of acceleration of run-off, it could be RoE accretive for the Group overall, so have you considered that in your plans?

Stuart Gulliver

Yes, look, certainly for the ABS book, the AFS ABS book, absolutely, that's the way we're looking at it. For the Household portfolio, we set out that we reckon we can do about $7.5 billion of sales over the period and about $13 billion of write-offs and actually just run down of the book to get it to $20 billion. We're unlikely to go beyond the $7.5 billion; that's the rate at which we think we can parcel up and sell portfolios of loans, unless of course the property market rallies incredibly, and the demand for these assets changes substantially. The other thing to just bear in mind is, once the book hits $20 billion, it's a book of $20 billion of performing loans that probably has a yield of 8%, so probably at that point in time, fully provided, etc, it's probably not a bad asset, actually, to have, quite honestly. So one shouldn't lose sight of that either, in terms of this analysis, but in the ABS/AFS, yes, that's absolutely how we run it.

Raul Sinha

Right, okay, and just to follow up on all the questions about the buybacks, obviously you are at 10.1% fully loaded Basel III; you said you organically generated 60 basis points or more, and that probably drives your rises in the DPS, but on top of that you will have gains from the Panama sale coming in Q3, you will have, potentially – you talked about Industrial Bank today, and maybe you will sell other assets over time, so should we think about those gains being used to effectively buy back the stock when the DPS rises in line with the EPS, or is that just a general…?

Stuart Gulliver

No, that's a general. You shouldn't think about it being a specific linkage of cash flow in terms of source and use of funds, no. Those types of gains will be put into the overall mix in terms of determining dividend at the end of the year. I wouldn't make linkage of disposals to buybacks.

Chintan Joshi, Nomura

Morning. Can I go to the US run-off again? If you think about the run-off piece currently about $1.5 billion a quarter; we've got 15 quarters to 2016, that would give me $22.5 billion, so already $41 billion is below $20 billion; plus you've identified sales and there'll be more sales that you'll identify down the line, so just wondering about how do you get to 20 billion? What is changing in this calculation?

Stuart Gulliver

I'm going to ask Pat, who's sitting about three feet from you, to answer your question.

Patrick Burke, Senior Executive Vice President & CEO, HSBC Finance Corporation

Sure. I think probably what you're saying is, as Iain's described already and Stuart's mentioned it, we don't have as much delinquency and ultimately charge-off in the book that we had in the historic quarters, so in effect the book is becoming stickier. It's not charging off as heavily as it did before, and the sequence of that really is delinquency improved first, and that happened in the middle of last year, and then we've seen the housing market recover, really just starting since the fall of last year, and both of those just caused a longer, if you will, maturity in the book.

Chintan Joshi

Thanks. And then if I move on to capital, greater than 10%, we've had one of your peers say 10.5. Where do you think the cushion needs to be? I mean, we have lack of clarity just now, but you've been traditionally a conservative Group. What do you think a buffer would be?

Iain Mackay

Above 10%.

Chintan Joshi

I knew that was coming.

Iain Mackay

You've got to allow us a few of those answers, right?

Arturo de Frias, Santander

Two questions as well, please. First of all, on the cost-income in some of the geographies. There are clearly two geographies that are under-performing the Group and the rest in terms of cost-income right now, which are the US and Europe. You have already given some colour on some additional cost-cutting, and even a cost-income target for the US, which is highly appreciated, but you haven't said anything new about Europe, so my question would be where do you think the cost-income of Europe should be in the next few years? I know you're going to argue that there's a lot of central costs and headquarter costs in Europe, but still; probably in the drive of 2-3 billion of additional cost saves, we would expect the cost-income of Europe to fall as well, and I would like to know more or less where. The second question is, I just would like to make sure that I understood what you said in terms of what would happen to your new RoE targets if regulators decide that the correct figure is not about 10 but 12. Will you stick to that target, and if yes, how do you think you will be able to reach a 12-15% RoE target with, let's say, a 12% core tier1 ratio? Thank you.

Stuart Gulliver

On the cost-efficiency ratio for Europe, look, sitting in the European numbers is the entire Group head office for the Group, is the OFAC fines from last year, is the bank levy and is the UK customer redress, so absent those the UK cost-efficiency ratio is…

Iain Mackay

54%.

Stuart Gulliver

Which actually is reasonable. The Europe first quarter 2013 was about 65 on an underlying basis, including the Group costs, so I think if you compare it to most European banks, it's not bad.

Iain Mackay

So if you think about what bank levy's probably going to be, and emphasis on the word 'probably' here, given that it's based on a year-end balance sheet, bank levy for 2013's probably going to be in the 800 million range. The operating costs for the holding company, if you look at the Group infrastructure, runs about 300-400 million per quarter, and that sort of gets you through, among certain other bits and pieces coming through, the European numbers, but then it sort of gets you to what the underlying operations of what sits in Europe. We've clearly got some fairly high-cost jurisdictions like France and Germany sitting within Europe, and then when you compare our CERs within those environments to the peer group, again, we're pretty well positioned against that, and certainly within the UK bank, I think we're quite well positioned from a cost efficiency perspective. The UK bank in particular has shown an incredible propensity to manage a very, very stable cost base over the course of the last four or five years.

Stuart Gulliver

The UK bank could be the poster child, in fact Sean was the COO of the UK bank, which was why I promoted him to be the Group COO, because the UK bank actually was way ahead of everyone else in terms of managing its costs base, so it's 54% for the UK bank within those numbers; the actual distortion you've got running through is because of everything we've just outlined.

Iain Mackay

On your second point around capital, if we see Common Equity Tier 1 of 12% then I think it clearly becomes a little bit more difficult, because the businesses would literally need to be delivering at the top end of the return on risk-weighted asset ranges that we've shown you today. Then the lower end of that return on equity could still be achieved, but you've got to be operating at the top end of that. You start moving Common Equity tier 1 ratios above that, then I think we probably need to start revisiting.

Stuart Gulliver

What would happen is we'd run everything back through the six filters and make the necessary decisions, is clearly what would happen. We've got, actually, obviously, people dialled into this, so if I can take a question from the phone lines, please.

Steven Chan, CITIC Securities

Good morning management. Just a simple question: when you formed your target on your return on risk-weighted assets, what sort of growth on your risk-weighted assets have you assumed when setting your target for 2016?

Iain Mackay

The focus around growth in risk-weighted assets is marginal improving returns, so when we look at incremental investment opportunity across the global businesses and regions, it's at incrementally improving returns to that which the business is currently doing. I mean, clearly we've got businesses that are operating within the range of return on risk-weighted assets that we've got but we've got others that clearly are not there, so we have to continue to churn capital through those portfolios to higher-returning assets, and certainly as we do incremental investment the focus is at return on risk-weighted assets that is in or above the range that we're currently operating at.

Stuart Gulliver

There's a tremendous focus and now process in place to ensure that incremental net new business is not written at dilutive levels and has to be written at the return on risk-weighted asset level to therefore not create a dilution.

Mike Trippitt, Numis

Three quick questions if possible; just interested in the slide on page 45 where you talk about this RWA growth. Do you see that that RWA growth, for example, in the faster-growing regions will be funded internally from capital generation, or do you see a movement in capital from the more mature markets into faster growing? And do you see any sort of regulatory problems in actually doing that?

Stuart Gulliver

Well, don't forget, the model that we've shown you is that capital all comes back to the centre and gets redeployed, so necessarily there effectively is a shift taking place.

Mike Trippitt

But do you see a regulatory hurdle to doing that?

Stuart Gulliver

No, because clearly we're at a level of capital within each of the operating entities to be able to effectively deploy the surplus that sits at the holding company level to generate marginal incremental growth in subsidiaries.

Iain Mackay

So in determining dividend policy for subsidiaries, it takes into consideration self-capitalisation and growth prospects over the short term, so all of the subsidiaries are separately capitalised, they maintain capital adequacy at or above the levels that are required locally, and when it comes to dividends it's got a prospect of future growth as well as obviously maximising and maintaining that capital at the centre of the Group.

Mike Trippitt

Okay, thanks, and could you give an idea of what, in your assumptions on the increase in returns, what tailwind effect you're assuming from rising rates?

Stuart Gulliver

Absolutely none. Zero. We're assuming that QE defers any rate rises beyond this period of 2014-16, so there's no lift in this from the deposit base.

Mike Trippitt

And finally, just headwinds from increased inflation. I was surprised that the 0.6 was as low as it was last year; I just wondered if you could give a figure.

Stuart Gulliver

I mean, emerging markets was kind of more like 2-3%, really, of inflationary pressure, which we kind of see as being around that mark again.

Gary Greenwood, Shore Capital

I just had two general questions, the first on the strategy targets. I was just trying to understand the nature of boardroom debates around those targets, and the sort of pushback that you may or may not have had; and the second question was on the culture, because clearly changing the culture is a key part of your strategy, and I was wondering where you were up to in your mind in terms of transforming the culture, and what else needs to be done.

Stuart Gulliver

I think, taking the second one first, I think the programmes in place to change the culture are what is required, but I think to change a culture takes seven years or longer, because I think that what you need to do is almost see out a generation who don't believe or sign up for that cultural change. I don't think we need to do anything more than the programmes we already have in place. The actual answer is to intensely stick to them, and stubbornly stick to them, and eventually you outlast those kinds of corporate deserters who don't get it. Quite honestly, I don't think it's more complicated than that. In terms of boardroom debate, clearly this was debated at the board, and I might actually ask Douglas to describe the boardroom debate, and we've actually got some of the non-executive directors at the back of the room, so maybe Douglas, you could just take this, I think it would be useful if you would.

Douglas Flint

Sure. There was, as you would imagine, a very strong debate, starting in January when we do the strategy offsite, and I think the mandate from the Board to management was 'Put down what you honestly believe the outlook is going to be for the period 2014-16, and then we'll challenge the individual pieces of it in terms of deployment in capital and returns and cost.' But there's no point in trying to stick to metrics that nobody believes are achievable just because they're consistent with the past or they're on a trend that some people might project. Honestly project what you think is right in relation to the risk profile, the risk appetite that the Board is giving you; and we had a strong debate, actually most around the cost side, around whether more could be done and making sure that there was no constraint on the continuing investment and commitment to all the cultural change programmes that Stuart's talked about, and indeed to the investment in control, internal audit, all the compliance and financial crimes stuff. If you put all that together you come to something that management felt comfortable with and the Board felt comfortable with. I mean, this is a plan absolutely endorsed and supported by the Board, and I think it's a challenging plan.

Andrew Coombs, Citi Investment Research

Morning. I've two questions, one just a very simple, quick question, point of clarification: when you talk about the timing of sterilising the scrip, you said from 2014; presumably that means sterilising the 2013 scrip dividend paid in 2014, rather than 2014.

Stuart Gulliver

No, the plan is 2014-16, so within 2014, and we will need to run through an AGM in 2014, so it's post the AGM.

Andrew Coombs

Right, that's very clear. And secondly, just in terms of coming back to cost-income, and more specifically the retail and wealth cost-income. We've talked a bit about US and Europe, but even when you look at LatAm, rest of AsiaPac, the cost-income there is obviously only elevated in the high 60s, therefore a drag on the mid-50s Group target you set, and I know you talked to us in the presentation about how the bulk of international Commercial Banking revenues are based on the city clusters, but presumably that's not quite to the same extent to the retail revenues. So, just interested to know what your thoughts are outside of the UK and Hong Kong, where clearly you do have significant scale; I know you have closed certain areas, there's a greater focus on premier elsewhere, but have you considered anything more radical in terms of restructuring in the LatAm and rest of AsiaPac areas?

Stuart Gulliver

No, look, we haven't, because I think that there's a big lever that we have still got to, or still have at our disposal to, deploy, which is actually to drive the costs down in those businesses. As I said at the beginning, this is the thing that has been run in the most local, local way, so, as Sean was saying, multiple internet offerings; multiple duplication of systems, etc, and actually the two and 20 countries are really well wealth-focused. It's a premier mass affluent offering, it's skewed towards wealth, but where we can drive the cost efficiency ratio down is not by, frankly, exiting those businesses, but by actually getting the cost base down. A chunk of this re-engineering and streamlining that Sean's talking about will directly come out of John Flint's business in terms of RBWM. So it's hard outside the firm to imagine the cost inefficiencies of allowing completely separate retail banking businesses to grow up with separate systems, platforms that don't talk to one another, etc and actually the cost opportunity of actually getting them on to common target business models, common platforms.

Frederik Thomasen, Goldman Sachs

I have two questions, please. Firstly, you've effectively raised your expected cost-income and your Core Tier-1 ratio, but you've reiterated your RoE target. I'm wondering, is the missing link simply lower credit costs because of the de-risking of the book, or am I missing something else? And then, secondly, on the strategies for upstream capital to the Group from the subs: I guess as I understand it, historically your FX risk to capital ratios was effectively managed by matching the local capital and the risk-weighted assets, so I'm wondering if there's a change in your approach to managing that FX risk.

Stuart Gulliver

There's no change in the approach to the FX risk, and actually what we're describing has been in place actually for some time. We take the capital out and then recycle it back in, so actually that's the way, frankly, the dividend that's paid to the external shareholders is funded. Clearly you'd get the dividend up from the operating company to the holding company and then pay it out to your shareholders, and that bit that's left over we then redeploy. What we're saying, the way we'll redeploy it will now be systematically managed in a very intense, focused fashion from the centre. The reason why we're confident to stick to the 12-15 RoE, and remember we did actually hit it in the first quarter, is because it's mostly the drag of the legacy businesses – that are on run-off. It's not about credit quality; it's the run-off portfolios. You know, there's $170 billion of RWAs that generate nothing, of legacy books. That's the big drag, and, as I say, if we were to walk away from the 12-15%, by 2016 we'll have missed it in the other direction because the legacy books will have run down.

Sandy Chen, Cenkos Securities

Actually, I just want to go back to slides 44 and 45 and, kind of, just talk to me about the capital upstreaming or forced dividend policy from the subs. Where does that start? I think you've said that you could actually force capital to be upstream from the lower-performing divisions, and then, moving to slide 45, you know, if that's so, why doesn't that chart show almost all of the discussion of RWA growth going to Alan's CMB division in faster-growing regions?

Stuart Gulliver

Well, because actually Alan's CMB division makes a great profit in some of the mature regions as well, is the honest answer. I mean, the UK CMB business is a fantastic business with fantastic returns, where we've set these international trade finance portfolios to lend, to trade business; it's got great returns on it. The UK numbers are distorted by all this customer redress and the bank levy and so on, so if you dig down the CMB business in the UK, the CMB business as we've built it out in the US, actually also have great returns, and the reason it's skewed towards CMB is for that reason.

Iain Mackay

On capital flow, Sandy, I mean, what we've described here is nothing new. This is how the Group has worked for many, many years. We're organised principally across bank subsidiaries operating in all our main markets. Those bank subsidiaries are in the vast majority of cases locally regulated, meeting local liquidity and capital standards. Where those businesses self-capitalise, create capacity, those dividends come up to the Group, and there's pretty strict policy around that. If people don't want to submit their surplus capital to us they've got to make a very clear explanation and a compelling case as to why they don't, and it better be based on regulatory changes or a very compelling case around growth. If they can't make those two cases, the dividends come to the parent company and they're redistributed in the mechanism that Stuart's described earlier, and that's been the case for many, many years. I think one of the things that we obviously are very conscious of at the moment is just the changing regulatory scheme here. The model that we've got works really well; there are those that think this model is probably the way you want to go forward, but what you've got to be concerned about and just keep a very close eye on is that we don't get capital Balkanised because people start to do the ring-fencing bit and say 'I'm going to take care of my economy and be damned with the rest of the world.' That's not that prevalent outside the US and the UK at the moment.

John Caparusso, Standard Chartered Bank

This is about, really, the trade-off between risk and growth. Stuart's talked a number of times over the past few calls about de-risking the business, and that's been very impressive. You can see it very clearly in the run-off portfolios and the sale of businesses. The question really is about the underlying growth HSBC. You talked a couple of times about how there's been a shift in the portfolio from higher risk to lower risk assets – you know, secure portfolios, trade finance and so forth. The question is, how do you think about, when you set your risk targets, how do you articulate that and how do you think through the trade-offs between how much growth you want to sacrifice to meet those risk targets and, specifically, as you said, de-risked over the past couple of years, how much do you think that you've sacrificed in growth for that, and how might that change going forward?

Stuart Gulliver

Sure. I don't think we've sacrificed much growth, actually. I think what we've done is reduced our loan impairment charges, and I think the PBT has actually benefitted for it, quite honestly. And I wouldn't overdo the lack of growth: if you look at slide 34, you can see quite clearly where we have substantial loan growth in the emerging markets. This is where we're showing total loan growth in the countries listed there of 24%, out-performing GDP two times, but that loan growth is in secured lending, it's not in clean lending. And in essence, yes, we as a Group Management Board do the maths to make sure that actually the numbers that we're setting out can be achieved with the risk appetite that we've described, because clearly there's no point in us embarking upon sending out instructions to everybody if actually the outcome's going to clearly miss all the targets we've set here today. The thing is, the firm is now run by a Group Management Board that really has 20 people on it that represents all the functions, all the regions and all the global businesses, so around the table is everyone that's required to basically run HSBC and execute the strategy, and actually we do a lot of analytics around this, so the six filters and so on is just the tip of a framework where we kind of actually work it through. It starts with a risk appetite statement that the Board actually puts in place, and the Board thinks through effectively what risks it wants to take and actually looks at various stress tests, which do include geopolitical events and bird flu and all sorts of things, and to make sure that we've not got all our eggs in one basket; we are diversified; that risk appetite statement then defines the credit risk and market risk limits that are delegated by the Board to me and then I on-delegate to the Group Management Board members. So there's a very kind of distinct organised framework in which this is constructed. This is an output of quite a lot of input and analytics.

John Caparusso

Sure, I don't question that at all. I think that's quite clear, and I recognise also that there's been pretty good asset growth, but there has been some sacrifice in margins, and I'm wondering to what extent that might trace back to your change in risk appetite.

Stuart Gulliver

No. The compression in margins does partly reflect the fact that we went from clean lending to secured. Obviously that happens at lower margins. What I'm saying is that the kind of test of whether this has been sensible over the last couple of years will be 'What's your PBT?' So, what's your risk-adjusted return? After you've taken account of your loan impairment charges and your bad debt write-offs, what's the bottom line? And so far, for this last point of the cycle, what we've done makes sense. Now, we clearly will adjust our appetite in terms of the balance as we see the economic cycle move through, but I think that so far we're quite pleased with the fact that we de-risked in this way.

John Caparusso

Yes; no, I don't question that at all. Thanks.

Chris Manners, Morgan Stanley

Two questions, if I may. The first one is, when you come to think about your targets over the next few years, I know you're saying you're expecting zero benefit from rising rates, but what is your base line assumption for the net interest margin from current run rate, because I guess you're still seeing the de-risking of the book, some competition re-emerging in some of the more appealing markets you've been talking about? And secondly, on the AD ratio, down to 73%: I mean, should we be able to expect that to trend up from here?

Stuart Gulliver

Sorry, on the AD ratio I think no. 90 is clearly a cap; it's a different type of target than the others, and we're comfortable that the AD ratio's actually gone down over the last two or three years. It partly reflects a positive selection on the part of depositors to actually move to HSBC. There has clearly been an in-flow of funding to HSBC and of course because we've sold certain businesses as well, the asset side's moved; so the AD ratio's both a deposit in-flow and a change in the sort of shape of the balance sheet. I personally think that it's a huge strength to run with an AD ratio, frankly, of around circa 75, so we could have mid-70s as a sort of descriptor of this going forward, but we would never, ever want to have this Group wholesale funded, ever. It is absolutely a core principle that probably started in about 1866, that this firm… I tell you for this, it's certainly at least 33 years old, because that's how long I've been with the firm, and I went into the trading rooms very early on and I was told this as something that was part of the folklore and the way the firm ran itself 33 years ago, so that's never going to change; so I don't see that. On net interest margin and spreads, there has been compression, actually, particularly from US banks entering trade finance and some the European banks coming back into trade finance. What you also have to bear in mind, though, is there's no kind of magic formula to this. These banks must be lending at rates that are generating a return on equity below their cost of equity, so this kind of spread compression doesn't go on forever. They themselves have an investor community, analysts to talk to, and they'll be trying to explain why they've grown their trade finance business but actually at RoEs below the cost of equity, so actually the phenomenon may well continue for the balance of this year, but I would doubt if it will continue beyond that, quite honestly.

Iain Mackay

If I just add a little of the nitty-gritty around that, Chris, I mean, the big move on net interest margins for this Group over the last 12 months was the disposition of the cards and retail service business in the US. That was a high-yielding business; risk adjusted, actually that was a well-performing business as well, but at a NIM level that was really the big driver. If you take that out of the equation, notwithstanding the fact we have seen a little bit of pressure in some of the markets over the last quarter or so, NIMs have remained very, very stable.

Chris Manners

Okay, so your sort of planning assumption when you develop your targets is a stable-ish NIM from here, then?

Iain Mackay

Yes.

Stuart Gulliver

Yes. At Group level.

Chris Wheeler, Mediobanca

If I could have three questions, the first one – sorry to get back to the dividend, but obviously you're setting quite a target in terms of your payout ratio, and I suppose the one concern is that the markets may turn down again at some stage in the future, and obviously cutting the dividend is always unattractive. Presumably, in your thinking on this and also your thinking on what your investors prefer, you will also be thinking about special dividends occasionally rather than anything else, or does that just make life too complicated?

Stuart Gulliver

I've spoken to three of the top five investors, who have indicated they would not want a special dividend. Their view is actually there are sufficient growths opportunities around in HSBC that they would prefer us to grow the balance sheet and grow the dividend by that way, and therefore to have an increase in the progressive dividend coming through in terms of the normal dividend. They feel a special dividend would add nothing to the share price whatsoever, and we'd have to be in a world that was massively ex-growth before we were kind of looking to do that. So I've gone and had that conversation already, actually, frankly, informing up the remarks that we have here about share buybacks, it's actually after talking to three of the very big shareholders.

Chris Wheeler

Thank you very much for that; that's very clear. The second question really is that twice during this morning you've talked about in-market acquisitions, which was intriguing. I suppose my question is, clearly, you've said that you'll comply with the six filters in doing any deal whatsoever.

Stuart Gulliver

Absolutely.

Chris Wheeler

But I suppose what I really want to know is, you know, you didn't seem to be referring to the sort of things you did in the Middle East or North Africa, something a bit larger. The question is, would you be willing to defer some of your targets for longer-term growth, perhaps, if you did such a deal, or would you just not be willing to do that and give up the 12 or 15 return?

Stuart Gulliver

No, we just wouldn't be willing to do it. What I think is hard to question is the ability of the management team of HSBC to manage organic growth within the firm, and actually what is questionable is the ability of HSBC historically to manage very large acquisitions. Thus I would not want to postpone any of these targets to make a large acquisition at all, and the six filters are there for a really good reason, so we will be incredibly disciplined about this.

Chris Wheeler

Thanks very much, that's clear as well. And the final question really is on a small part of the business but an interesting one, in private banking. I mean, 49% of your private earnings last year came out of Europe, and it sounds to me like you've been very clear on what you think about part of the Swiss business, and also, I assume, that means why we saw the stories on Monaco last night coming out on the wires. Are we seeing a business where we're going to see quite a marked step-down in earnings in perhaps the short term as you build your new model of being very much aligned to the Commercial Banking business as a result of that?

Stuart Gulliver

I think it's important on the Swiss piece to understand that what we need to do is reposition it. We're not going to exit the Swiss private banking business; we're not going to sell the Swiss private bank. We need, however, to reshape certain parts of it, and certain parts of the business, therefore, that we acquired from Republic doesn't fit with, effectively, a private bank that needs to be kind of emerging market-focused and focused alongside our Commercial Banking business. But it's a restructuring, not an exit of the business. We remain absolutely committed to private banking, including our Swiss private bank, to be crystal clear in this regard. In terms of earnings and so on, yes, it is possibly the case that there will be a modest dip in private banking earnings as we restructure it, but the private banking business makes a PBT of about $1 billion, so it's not really going to kind of significantly drive the valuation of the firm, but it would be true to say that we would expect a little bit of a kind of J-curve effect as we run through a restructuring. But I stress, it's a restructuring. We're not disposing of the private banking business; it would be absurd to do so. We are operating in countries that have phenomenal wealth creation, so therefore it's a kind of core service to be able to offer.

Michael Helsby

I've just got a follow up on costs, actually. Sean, you highlighted a few industries that you've clearly looked at that have demonstrated very strong absolute cost reduction, and I think despite taking out $3.3 billion of costs if you look at 2011 and look at where we are today, for many different reasons I think costs, ex-notable items and ex-disposals, etc, are actually higher today than what they were when you started this programme, so again, clearly there's a lot of things going on. You talked about the risk framework from compliance, etc, but I was just wondering if you could help us think about what you consider to be the base level of cost growth that sits within HSBC – that's before any sort of revenue performance-related, but when you look at the inflation, you look at the investment you need to make, ex-the cost savings, what that base level of cost growth is.

Iain Mackay

I wouldn't necessarily talk about a base level of cost growth, because we're made up of businesses in four global businesses, 80 markets, six regions and the dynamics are different by market, but I think what we've provided some guidance and insight around, and which we continue to do through the IMS, the Interim Report and the Annual Report, is where do we see costs running at the moment, based on where do we see costs running on a quarterly basis? And that's sort of in the high 8s, low 9s on a quarterly basis. And then, really, what the cost base is going to be informed with is continue to drive sustainable saves. The focus of why we do that is fund investment; deal with inflationary pressures; that's really what the focus is here. Positive jaws, right? It's going, by definition, Michael, it's going to be different by global business, by region, based on circumstances we're dealing with, based on the state of restructuring in the businesses. You know, Stuart talked earlier about the degree of restructuring we still need to do within the Retail Bank and Wealth Management; now, that's not to suggest that's the only place we need to do it, but this is a composite of a lot of different elements. But I think on a Group level, if you think about high 8s, low 9s, and then we'll continue to feed you information about what are the notables that come through about that, whether it's customer redress, whether it's fines/penalties, and try and provide clarity about that. And I think as we move forward here we'll hopefully continue to give you more detail about where we're investing, and what kind of payback we're getting on that as well.

Sabine Bauer, Fitch Ratings

I have a question on the strategy for The Hongkong and Shanghai Bank. You mentioned a little bit on the new business generation as related to China, but I was interested in learning more about the Hong Kong businesses, the domestic business. Is there significant growth coming from that area with Hang Seng Bank being part of your network? And then a bit broader, on the faster-growing markets: you mentioned it a couple of times, but can you give us more detail on which faster-growing markets in Asia-Pacific would be in the focus to meet these targets and in particular the ways how the Asia-Pacific region will be complemented by Latin America?

Stuart Gulliver

Well, Hong Kong's underlying profit before tax growth in the first quarter was 14.4%, so we continue to have a terrific business in Hong Kong that continues to grow substantially. The underlying revenue growth of about 9.3-9.5% was well spread across all the global businesses but was led by Global Banking and Markets. Actually, we continue to have an excellent business in Hong Kong, as does Hang Seng, that are incredibly well managed, and we continue to see Hong Kong's role, frankly, as the RMB internationalises, as one of increased opportunity. I think the internationalisation of the RMB will actually benefit Hong Kong, will not be negative for Hong Kong; the Hong Kong business continues to absolutely be the jewel in the crown for HSBC and, as I said earlier, I think what happens over the next three-five years is this much more open border between Hong Kong and Guangdong will create further opportunities to grow a kind of economic corridor and a conurbation. I might ask Peter, who's actually sitting in the front row here, just to talk a little bit about the growth opportunities he sees specifically in Hong Kong, and then I'll talk about Rest of Asia-Pacific.

Sabine Bauer

If I may just add one more question: how much of the Hong Kong business is actually related to China?

Peter Wong, Chinese Asia-Pacific CEO

I think to some extent we should look at Hong Kong, when you look at the strategy of Hong Kong, you should also include China, because a lot of the activities in Hong Kong, especially the fund-raising activities from the businesses, they are actually investing in China. And to certain extent, we can also see that China is using Hong Kong as a pilot for RMB internationalisation, so a lot of products from China, especially on RMB, are coming to Hong Kong, especially on debt, especially on trade. And that will continue to grow. China, at this point in time, is number one in export and number two in import, and a lot of the trade in terms of using RMB as settlement… It was about 3% two years ago, now it's up to 12%, and Hong Kong is taking a big part of it, so there will be lots of opportunities regarding the RMB.

Stuart Gulliver

If you look at the Rest of Asia-Pacific, I mean, back in May of 11 we said that we reckon we could make $1 billion out of Singapore in five years' time from 2011, so 2016; a billion out of India and a billion out of Malaysia and Indonesia, so if you look at the end of 2012, India was at $810 million, Singapore was at $700 million and Malaysia and Indonesia combined were at $900 million, so pretty advanced towards hitting those billion dollar targets. They're very important countries; the GDP growth, we think, will be 3-5%; the demographics are incredibly powerful, and we have superb market positions in all of them. And you saw a little bit on the reported level of slowing in Rest of Asia-Pacific, but part of those numbers is distorted by big changes going on in disposals through those Rest of Asia-Pacific numbers in 2011-2012. On an underlying basis, the Rest of Asia-Pacific numbers are actually very, very strong. Underlying first quarter PBT in Rest of Asia-Pacific, if you strip out the Industrial Bank gain, disposals and the sale of the balance of Ping An was broadly unchanged versus the first quarter of 2012, and the lending in RBWM and CMB have both increased. So we're very constructive about that opportunity for HSBC.

Manus Costello

The number for the UK bank levy you just gave, Iain, was quite a bit ahead of where consensus has you, I think, for 2013, and I just wondered is there anything you can do to mitigate that for balance sheet perspective; to you, Iain, and to Stuart and Douglas, is there anything you can do to mitigate it politically, because it strikes me that the Group is being disproportionately hit, because I suspect you're not benefitting as much from the lower UK corporate tax rate, that you are being hit as that levy rises?

Iain Mackay

We did mention that 800 million, by the way, at the time that we put the full year results out in 2012, and it's a function of the increase in rate. What we have done over the last two years is an enormous amount of work, really, under the detailed rules. Part of the challenge – well, there are multiple challenges with the bank levy, but in its application, one of the challenges is it's incredibly detailed. It's far too complex in its application, but we've got a gentleman working in our tax team who probably understands this better than anybody. He's worked with our regional teams, our balance sheet management teams, around really understanding – not changing the shape of the balance sheet, but understanding what counts and what doesn't count, and making sure that we take the full benefit of applying the rules accurately and appropriately. And that, actually, has realised some benefits for us over the 11-12 period. What drives the change for 2013? Nothing other than the rate increase. That's really what it is, based on our outlook balance sheet. On the influencing aspects, perhaps Douglas, have you got any comments there?

Stuart Gulliver

I think both Douglas and I have had all of the conversations that we could possibly have, with all of the people we could have them with, and I believe that there will be no change at all this side of a general election. We've got time for one last one. If there aren't, thank you very much for your interest and attention. The schedule now is, basically the whole Senior Management Team are here; we will also be serving refreshments, lunch, on the floor where some of you will have had coffee before starting this, and basically everybody's at your disposal until kind of 13.30 or thereabouts. The three of us have to go and do a press call, and then we'll join everyone. Thank you.