# FINAL TRANSCRIPT

Thomson StreetEvents℠

# HBC - Interim 2009 HSBC Holdings plc and Q2 2009 HSBC USA Earnings Conference Call

Event Date/Time: Aug. 03. 2009 / 9:45AM GMT



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

## CORPORATE PARTICIPANTS

**Stephen Green**
*HSBC Holdings plc - Group Chairman*

**Douglas Flint**
*HSBC Holdings plc - Group Finance Director*

**Michael Geoghegan**
*HSBC Holdings plc - Group Chief Executive*

**Stuart Gulliver**
*HSBC Holdings plc - Chief Executive, Global Banking & Markets*

**Sandy Flockhart**
*HSBC Holdings plc - CEO, HSBC Asia Pacific*

## CONFERENCE CALL PARTICIPANTS

**Alastair Ryan**
*UBS - Analyst*

**Robert Law**
*Nomura - Analyst*

**Roy Ramos**
*Goldman Sachs - Analyst*

**John-Paul Crutchley**
*UBS - Analyst*

**Leigh Goodwin**
*Fox-Pitt Kelton - Analyst*

**Sunil Garg**
*JP Morgan - Analyst*

**Michael Helsby**
*Morgan Stanley - Analyst*

**Bill Stacey**
*Aviate Global - Analyst*

**Sandy Chen**
*Panmure Gordon - Analyst*

**John Waddle**
*Mirae Asset Securities - Analyst*

**Ian Smillie**
*RBS - Analyst*

## PRESENTATION

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Well, good morning, ladies and gentlemen in London, good afternoon here in Hong Kong, and thank you for joining HSBC's 2009 interim results presentation. As usual, we have a satellite link to jointly present in London and in Hong Kong. I am delighted to be able to be here in Hong Kong in person this time.



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

My Hong Kong colleagues do not really need introduction, but I will do so all the same. I have to my right Vincent Cheng, Chairman of the Hong Kong and Shanghai Banking Corporation, and to my left Sandy Flockhart, its Chief Executive. But we also have with us Edgar Ancona, the Chief Financial Officer here in Hong Kong, and Russell Picot, HSBC's Group Chief Accounting Officer. At the London end we have Mike Geoghegan, Group Chief Executive, Douglas Flint, Group Finance Director, and Stuart Gulliver, Chief Executive of Global Banking & Markets.

Before we start the presentation, can I ask you to take a minute to read the usual forward-looking statements on the screen before you now?

Let me run through the reported headline numbers for the first half. Profit before tax $5b. Profit attributable to shareholders $3.3b. Earnings per share $0.21. Return on equity 6.4%. Tier 1 ratio at 10.1%, just above the top of our target range, and core equity tier 1 ratio of 8.8%. Dividends for the first half at $0.16 per share, with a total value of $2.8b.

This time, there is a major impact in our reported results from movements in fair value on our own debt, related to credit spreads. This is not part of the managed performance of the Company, does not affect cash flow or dividend potential or capital ratios, and so we have stripped this out of our profit figures. On this basis, profit before tax was $7.5b, attributable profit $5.6b.

The numbers demonstrate HSBC's resilience and ability to deliver results even in what have been difficult financial markets and a recessionary economic environment in much of the world. The operating performance of the business is broadly maintained, compared with the first half of last year.

We have strengthened our position in the faster-growing markets, for example, in China, where we are the leading international bank. The value of our investments there rose by $8b in the first half. We continued to open new branches, we launched new rural banks and we introduced new renminbi services.

Elsewhere in the region, we doubled our presence in Indonesia. We were the first foreign bank to incorporate locally in Vietnam. We integrated the Indian retail broker acquisition, enhancing our wealth management business there. And we continue to see growth opportunities in the faster-growing regions that are our strategic focus.

We are comfortable with our capital strength, strongly boosted by the rights issue earlier this year. And we are also generating capital net of dividend payments. The balance sheet is buttressed by very strong liquidity, with an advance to deposit ratio of 79.5%. Our costs are down and our cost efficiency ratio is significantly improved. We have shown record profits in Global Banking & Markets.

And what I am now going to do is to hand over to Douglas and Mike in London, Douglas to cover the financial performance, capital, liquidity and risk management, and Mike to cover the first half business performance, including Global Banking & Markets' successes, the tight cost control, and our progress in handling our US Consumer Finance business. Douglas, over to you.

---

**Douglas Flint** - *HSBC Holdings plc - Group Finance Director*

Thank you, Stephen.

This slide sets out the reported income statement for the last three half-years. And we have presented separately the goodwill impairment in North American PFS last year and the movements in fair value of our own debt, which are related to credit spreads, which we do not include in managed performance. More relevant, since capital has been such a feature over the last 12 months, neither of these items impact regulatory capital.



THOMSON REUTERS STREETEVENTS | www.streetevents.com | Contact Us

©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

The major takeaways from this slide are that capital generation was much stronger versus the second half of last year. And while loan impairment charges rose against the first half of last year, they are down against the second.

Before we look at the numbers on the usual underlying basis, can I remind you of the significant factors that we highlighted last year and add this period's comparatives. As well as movements in fair value on our own debt related to credit spreads and the goodwill impairment in North American PFS, which I have already mentioned, the other factor to note is that the write-downs in Global Banking & Markets have progressively declined over the last three periods.

One final point. Had we treated, and we did not, but had we treated the rights issue as a derivative liability instead of an equity transaction, the movement in our share price during the rights period would have been reflected as an element within our reported performance. On reflection, the Board concluded that this would fundamentally distort the presentation of our performance and that a true and fair view override was necessary and our auditors concurred with this view.

I also note, in passing, that the IASB voted at their July board to expose for comment a specific revision to IAS 32 which would remedy this anomaly. And we expect this to be formally part of GAAP shortly and so there should be no need for a true and fair override in our full year accounts.

Looking at the underlying results in the usual way, that is, stripping out the impact of foreign exchange and acquisitions and disposals, and also showing separately the impact of goodwill impairment and the fair value movements on our own debt related to credit spreads, because these do not impact capital, you can see that revenues rose by 10%, while costs fell by 3% in the period. While the charge for loan impairments and other credit risk provisions increased substantially, because of the very positive jaws, our underlying profit before tax was down by a more modest 9%.

Looking at the current period versus the second half of last year, again, you can see the very distorting impacts of goodwill impairment and credit spread movement on our own debt, again with no impact on capital, which is why we have separated them. On this basis, operating income before loan impairment was up by 17% and costs down by 5%.

The other factor to note is that loan impairment charges were 3% lower in the first half of 2009, within which North American PFS services charges were lower by $1.4b or 15%.

This slide illustrates the movement in the quantum of tier 1 capital. Clearly, the major movement is the rights issue proceeds. However, in evidence of the fact that movement in our own credit spread does not impact capital, we generated, on a capital basis, some $4.7b in the period from operations, against which is offset $1.9b of dividends net of scrip, i.e. the dividends were more than twice covered.

Risk-weighted assets were broadly flat, as we targeted, and so the tier 1 ratio improved to 10.1% from the pro forma 9.9% that we showed at Q1, incorporating the rights issue pro forma.

I would also note that, in passing, of the $1.2 trillion of risk-weighted assets, perhaps, and it is a broad thing, perhaps some 20% in aggregate supports the run-off portfolio in the US Consumer Finance business and the legacy structured credit and asset-backed securities portfolios in Global Banking & Markets.

Looking at customer loans and advances, advances were lower, primarily reflecting the run-off in the Consumer Finance portfolios in the United States, a reduction in wholesale balances, both in assets and liabilities, and muted credit demand across most major geographies.

As far as liabilities were concerned, we grew deposits strongly in Personal Financial Services, particularly in Asia, Global Banking & Markets saw deposits fall as major counterparties de-leveraged, and there were lower transactional balances within some of our custody and payments businesses. The advances-to-deposits ratio ended up at just under 80% at the end of June, and we would regard this as marking perhaps the lower end of the range within which we seek to position the Group.



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Turning to risk and related charges, in Personal Financial Services you can see that loan impairment charges expressed as a percentage of average advances were elevated compared with the first half of last year and broadly flat compared with the second half. Hong Kong remained the best performing market in terms of loan impairment charges in Personal Banking, as it has been for some time.

In Commercial Banking, we saw increases across most geographies, albeit in many cases coming off historically low bases, and inevitably this reflected the weaker economic conditions and the impact of the decline in trade flows. And while there was a substantial but manageable deterioration first half on first half, the dollar charge in the first half of 2009 was lower than in the second half of last year.

We have not shown a separate slide for loan impairment charges in Global Banking, but these were $1.2b against a relatively small number of troubled relationships.

Turning to the risk elements within Global Markets, firstly, the write-downs in respect of legacy trading assets have declined substantially from the first half of last year, from $3.9b to less than $1b, as credit markets have stabilized and credit spreads tightened. In the available-for-sale asset-backed securities portfolio, the transfer of fair value deficits through the income statement on recognition of any element of cash flow impairment accounted just over $0.5b, and this is in line with the guidance we gave you in March. As in past periods, we consider this to be a multiple of the actual projected expected loss.

The AFS reserve has fallen modestly, both from the transfer to the income statement of fair value deficits for impairment is recognized, as well as amortizations. And the benefit from improved pricing is less than you might have expected, as the portfolio remains highly illiquid, in large part due to the onerous capital requirements of these securities under the capital rules of Basel II currently.

Overall, we remain comfortable that the stress test figures that we disclosed to you in March remain valid, with an expected impairment from the beginning of this year of $2b to $2.5b, with an ultimate expected loss of $600m to $800m.

Now let me hand you over to Mike for the business review.

---

**Michael Geoghegan** - *HSBC Holdings plc - Group Chief Executive*

Thanks, Douglas.

In these tough times, we are very clear about our priorities and the direction in which we wish to take this business. We have further enhanced HSBC's signature strength over the first half, after paying cash dividends. We are now deploying our capital base conservatively, to build long-term sustainable return to our shareholders.

We have stood aside from the aggressive competition for deposits, driven by government-influenced banks. Even so, customers are still choosing to place their deposits with HSBC, and our published advance-to-deposit ratio was a conservative 79.5%. Deposit spreads remain compressed, of course, but we are even more convinced of the importance of maintaining HSBC's distinctive liquidity position. That is the key from which we can expand profitability when interest rates recover.

I will now take you through our business performance for the first half of the year in more detail. And as I do so, I will highlight our progress in four core areas.

First, we have maintained a strong grip on costs, achieving significant positive jaws. Second, thanks to our broad-based business model, we increased our revenues year on year. Third, we have continued to provide responsible support for our customers and build that customer base, ready for when the global economy recovers. I will cover the performance in each of our businesses



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

in turn. And finally, in the USA, the restructuring of HSBC Finance is on track. And as a result of all of this, we have strongly positioned HSBC for the upturn and the opportunities which lie ahead.

When I became Group Chief Executive, a core premise behind my thinking about joining up the Company was that HSBC should be able to operate and write additional businesses from a lower cost base. These results prove we are achieving this success. We often talk about the benefits of scale that HSBC enjoys, but here is real evidence of this coming into play.

Compared with the first half of 2008, we grew revenues by 10% on an underlying basis and excluding movements in fair value on our own debt related to credit spreads, yet over the same period we reduced our costs by an underlying 3%. And this excludes the goodwill impairment incurred in 2008 and was after restructuring costs in the USA. Comparing against the second half, the picture is even clearer, with revenues up 17% and costs down 5% on the same basis.

Let's look at our revenue growth in more detail. This slide highlights our resilience in difficult market conditions. Here, you can see the diversification of our business by region. Revenues were broadly stable in Latin America, Asia and the Middle East. The increases in Europe and North America are largely thanks to the revenues from Global Banking & Markets. This geographic diversity positions us well to grow our revenues in line with our strategy.

At HSBC, we run a balanced business. In this half it has been Global Banking & Markets which has been most able to seize the opportunities, but each of our customer groups is an important component of HSBC's success. Few financial organizations today benefit from such a broad-based platform by both geography and customer group as HSBC.

I will now move on to our customer groups, starting with Global Banking & Markets. This record performance highlights the continued success of our emerging markets led and finance-focused strategy which Stuart Gulliver put in place when he took charge of this at the end of 2006. We are now reaping the benefits of a strategy which has been consistently applied ever since.

As you can see, we have achieved a good balance between fast-growing and developed markets. We are very comfortable with this geographical split of business and its scale. Of course, as you know, market conditions were favorable during the period for all. Performance in Global Banking & Markets in the second half, therefore, partly depends on whether this continues.

This slide shows how our growth is broadly spread across different product areas. It also emphasizes that HSBC is well placed to benefit from the actions and decisions of clients during this downturn. Record performance in the rates business and strong foreign exchange revenues underscores the strength of core products. We have also seen clients turn to HSBC to help them access the markets as they reopened. This is illustrated by the increase in our financing revenues compared with the first half of last year.

HSBC is also ranked first in the Bloomberg bond league tables, combining all issuance, in Europe, the Middle East, Asia excluding Japan, and Latin America. Again, the benefits of our integrated business model come through in the current low interest rate environment.

Balance sheet management generated significantly higher treasury revenues. This was achieved by actively managing the surplus deposits of the other customer groups and by correctly positioning for lower interest rates.

Next, Commercial Banking. This is a business which has consistently delivered sustainable profits for the Group. Its first half performance reflects the strength of our international business model and our brand. Customer accounts have remained high, reflecting the flight to quality during 2008. Over the last 12 months, we have seen an increase in foreign exchange revenues of 18%, trade revenues were up 11%, and global links referral volumes were up 7%.

Credit quality has inevitably deteriorated over the last 12 months, given the challenges which our customers have faced. However, loan impairment charges were stable compared with the second half of 2008. It is too early to draw any firm conclusions about long-term trends, but we are encouraged by what we have seen so far this year.



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

The growing contribution of emerging markets is something that you can see right across the Group. Here is clear evidence of this in Commercial Banking. Customer numbers have increased by 8% to 3.1m over the past 12 months. 61% of these new customers are based in emerging markets. In fact, the percentage of customers in emerging markets is growing steadily. This looks positive for the future.

The economic environment has been hard for depositors, who make up the majority of our PFS customers. As a deposit-rich bank, HSBC is also suffering, bearing the brunt of the compressed deposit spreads. Importantly, our liquidity position will drive strong revenue opportunities when normal interest rate environments return.

PFS, overall, remains solidly profitable outside of North America, driven by an encouraging performance in Hong Kong. Levels of loan impairments were disappointing in Latin America, the Middle East and India, but we are dealing with these right now. I will say more about our North American business in a moment, where there is also progress to report.

Even in the current environment, HSBC is one of the main winners, and we are gaining new and affluent customers. Over the last 12 months, the total number of HSBC Premier customers grew by 23%, to 2.9m. In fact, the screen in my office says it is now more than 3m. We have grown our business in mortgage lending too. Our share of the mortgage market increased in both UK and Hong Kong during the period.

Now, turning to the USA. We are satisfied with the progress achieved in the first half. All parts of the run-off Consumer Finance portfolio declined during the period, in total by $9b. The majority of our customers continue to meet their obligations and we are supporting those in difficulty where we can. During the first half, we modified loan obligations of over 69,000 customers, with total mortgage value of nearly $10b.

Looking in our core business in the USA, the cards portfolio reduced faster than expectations, as a result of early action taken in tightening underwriting. The cards business was also profitable overall, despite the current economic conditions.

We remain clearly focused on managing risk within our consumer lending portfolio, but we have been encouraged by the two important trends. Firstly, we have seen evidence of stabilization of dollar amounts on our 2-plus delinquencies. And secondly, the increase in 2-plus delinquencies as a percentage of total loans has also begun to moderate. We are therefore seeing less need to bolster provisions. Two quarters are not a trend, but they give a clear signal. We are satisfied with what we have seen so far this year.

In Private Banking, client de-leveraging and low risk appetite impacted both fee income and client assets during the period. However, our performance was robust. Pre-tax profit was down by 23% compared with the record first half of 2008, but is in line with our second half.

Our Bancassurance strategy has delivered impressively in the fast-growing markets. We have seen growth in profitability in Hong Kong, Brazil and Singapore. We have also cemented the foundations for the future growth by establishing platforms in India and China. In particular, we are committed to increasing our client penetration rates for life, wealth management and critical illness insurance.

In summary, HSBC has had an encouraging and exciting six months. Throughout the turbulence of the last two years, and again over the last six months, we have proven our ability to deliver through diversity.

At HSBC, we measure our performance against a set of benchmarks. Our return on shareholder equity for the period was 6.4%. Obviously, this was well below our target range of 15% to 19% through the full business cycle. However, the circumstances when most major markets were in recession, we believe that this is acceptable. And we also believe the target remains achievable when conditions normalize.



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Our cost efficiency ratio was, for the first half, 47.9%, slightly better than our target range. An important driver behind this is the One HSBC program. This is a core strategic initiative which we launched in 2006. Its purpose is to leverage our economies of scale, improve customer experience and improve efficiency. But it is not just about cost; it is about revenues too. Let me give you some real world examples of One HSBC in action.

First, by the end of June, 50,000 large corporates were using our online financial management service, HSBCnet. Secondly, by the end of 2009, we expect our global payments platform to handle more than three-quarters of the Group's high-value payments. Third, we also expect to have more than 80% of our cards on a common world platform by the end of the year. This will reduce the reliance on external service providers and help us reduce processing costs. Of course, there is much we can do and we must do to join HSBC, but we are pleased with the real and tangible progress we are now seeing.

Next, our tier 1 capital ratio was 10.1%, which stands slightly above the top of our target. We remain very comfortable with HSBC's strong position at this point.

Finally, total shareholders' return is below the target at the half-year, but over the duration of the crisis it has been broadly in line with the peer group average.

In closing, it is worth saying that this success in executing our Group strategy has not gone unnoticed elsewhere. We are proud of HSBC's strong global reputation. We were therefore delighted to be recognized as Euromoney's Global Bank of the Year in 2009. We were also named the world's top banking brand by Brand Finance. Thanks to this powerful brand, customers are continuing to choose HSBC for deposits, for borrowing and for all financial services.

We have a global footprint that is second to none, and our balanced business model has allowed us to increase our revenues whilst reducing our costs. We continue to provide responsible support for our customers and deliver profits. And we have made good progress in restructuring our US Consumer Finance business.

As a result of all these factors, we believe we are well placed for the upturn and we are confident that customers with international needs will continue to come to HSBC.

Thank you and I now hand you back to Stephen.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Mike, thank you. To summarize, HSBC is strongly positioned for the upturn when it comes. We have seen improved operating conditions in the financial markets. We may be at or around the bottom of the downturn. The timing of the recovery is, of course, still uncertain, but we believe that HSBC is well placed for when it comes.

Our capital strength and our capacity, therefore, to grow risk-weighted assets and still maintain strong capital ratios, our deposit-rich balance sheet with the ability that this gives us to meet customer demand for credit, our strong global footprint with the opportunity to participate in faster-growing economies and to service the need for connectivity between markets, and lastly, our economies of scale, demonstrated through tight cost control as revenues rise, which will feed through to the bottom line.

So there is no institution better placed than HSBC to deliver sustainable growth for our shareholders and to contribute to balanced economic development. Whilst the timing of economic recovery of course remains uncertain, we are confident of HSBC's ability to deliver results over the long term.

We are happy to take your questions now. To ask a question, please raise your hand, either in London or in Hong Kong, and we will get a microphone to you. I will invite the questions in Hong Kong. Mike will do the same in London. We would be grateful



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

if you could give your name and your organization before you ask your question, and please, one question per turn. And to avoid confusion between London and Hong Kong, I will indicate, if I may, who will answer each question.

Now, first over to you, Mike, in London, for a first question or two.

## QUESTIONS AND ANSWERS

**Michael Geoghegan** - *HSBC Holdings plc - Group Chief Executive*

Okay. Three rows back, please. Alastair?

**Alastair Ryan** - *UBS - Analyst*

Thanks. Good morning. Alastair Ryan from UBS. Could I ask, it is slide 67 of the slide pack, in mortgage services, clearly, as delinquencies have declined and the size of the book is declining, you are now feeling confident in running down the level of reserves somewhat. It feels like we should be there fairly quickly in the other books, in household as well, whether that is something you would be comfortable to comment on. What drives that flip over from the pretty aggressive reserve build you have had over the last 18 to 24 months to being comfortable in drawing that down?

A brief second one, if I may. The very low marginal cost/income in Stuart's business in the first half, that is obviously against a very high starting point, or an unusually high starting point, just whether there is any particular drivers to draw out there, please? Thank you.

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Alastair, thank you. Mike, let me suggest, between you and Douglas, you take the first one and Stuart the second one.

**Michael Geoghegan** - *HSBC Holdings plc - Group Chief Executive*

All right. Well, clearly, Alastair, you talk about the trends. You are absolutely right. We are seeing a couple of trends now beginning to develop. And it looks like we were projecting a situation that was worse in regard to unemployment, and we do see a decoupling at the current time in regard to actual delinquencies and unemployment. Now, if that was to continue, then that would be a very positive position for us.

But, as you see, there are two things happening. One is the running off of the book, particularly in mortgage services, now probably halved since we first told you this in March 2007. And the second part of it is the consumer lending side is, although weak, is not as weak as we were expecting.

Douglas, do you want to add there?

**Douglas Flint** - *HSBC Holdings plc - Group Finance Director*

Yes. We built provisions over the half by about $600m, but in the second quarter, for the first time in as long as I can remember, there was a reduction in both mortgage services and indeed in the cards business. The cards business is driven by volume. The book came down and therefore charge-offs, of course, are backward-looking, impairments are forward-looking, it was a smaller book.



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

In mortgage services, the book has halved since we started. And I think what you are now seeing is partly a mix change, i.e. the seconds are much smaller as a proportion of what is left. And very little has been put on in the last two, almost three years, and therefore you have got a very seasoned portfolio which is just maturing and amortizing. And therefore, given the conditions in the first half, there was no need to add to the stock of provisions which we have been doing, I think, for something like 11 successive quarters. So it is exactly as you describe it.

---

**Stuart Gulliver** - *HSBC Holdings plc - Chief Executive, Global Banking & Markets*

Yes. Alastair, cost/income ratio at 36 was mainly driven out of very strong revenue growth. The costs are basically more or less flat. They are slightly down, obviously, on the first half of 2008 (that reflects the fact we took 1,650 people out of the business during 2008) and slightly up on the second half, because obviously there is a performance accrual going through. But the big delta on the cost efficiency ratio is the revenue line, at $12.2b.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Next question. Yes.

---

**Robert Law** - *Nomura - Analyst*

Robert Law at Nomura. Could I just press you a bit more on those two issues, if I may? At the start of the year, you gave guidance as to the kind of credit impairment we might see at HSBC Finance in relation to unemployment, and certainly the answer to the previous question seems to be changing that somewhat. But in the past you have seen quite significant second half/first half differences in the experience at HSBC Finance. Can I invite you to comment on the guidance you gave at the start of the year in relation to rises of unemployment of about 1%?

And secondly, on the GBM efficiency ratio, and obviously the ratio down at 44%, I think I worked it out, but maybe I have got it wrong. Even if you add back balance sheet management, it is something like 50%. That is very different from the kind of efficiency ratios you are seeing at other investment banks. Is that the kind of number that you would look to be sustaining, if you can sustain this kind of revenue number?

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Well, Mike, let me suggest you and Douglas carry on on the first question, again Stuart on the second.

---

**Michael Geoghegan** - *HSBC Holdings plc - Group Chief Executive*

All right. Clearly, when we gave you guidance at the beginning of the year, what we were looking at was a trending up in unemployment. And, at that stage, there was a clear correlation between our impairments and unemployment, which you would expect in the card businesses and possibly to a lesser extent in mortgages.

What we have seen is something interesting to the extent that sub-prime borrowers in regard to cards seem to behave differently to near-prime and prime cards. In some ways, the sub-prime card holder is more alert to a downturn. He is able to adjust his approach to living, whereas the near-prime and the prime have found it more challenging to change their lifestyle. So what we are seeing is an improvement there. And also, as Douglas said, there has been a marked reduction in debt in the United States, which you have seen across all US institutions, but it has come quite quickly into our card business, with receivables significantly down in the first and second quarter.



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

So it is hard for me to give you a projection of where unemployment goes. If unemployment was to spike significantly in the second half, well, then there must be some correlation. But at the current time, that correlation is not staying to the position we said at the beginning of the year, and it is positive to us.

Stuart?

---

**Stuart Gulliver** - *HSBC Holdings plc - Chief Executive, Global Banking & Markets*

Yes. The cost/income ratio on page 35 of the ARA is 36. If you do reverse out balance sheet management, you get up towards 50. Robert, if you are asking the question, if we continue to make $12.2b each half-year, will the cost/income ratio stay where it is, I guess the answer is yes. But the chances of making $12.2b is something you should evaluate.

I do not think the business needs to get more expensive to run, because we are hitting revenue at a better level. We have been a huge beneficiary of increased business in the first half because I think in a lot of the countries we are operating in, and do not forget Global Banking & Markets is in 67 countries, clients are asking themselves are you in wholesale banking in 10 years' time, are you in my country in 10 years' time, and they are selecting the banks that they think are survivors. So there is a bias going through our sales and trading numbers which is about increased market share, increased volume in an environment where there are wider spreads. And that does not mean my business re-prices on the expense side.

---

**Douglas Flint** - *HSBC Holdings plc - Group Finance Director*

Robert, if I could just add a little bit on the first bit, I think you pointed to something very important here. The guidance we gave was very much on a full year basis. There is a seasonal impact and I think the seasonal impact has been accentuated this year. On top of the tax refunds, there is also been a number of government programs that have put cash into consumers' pockets and they have had the benefit of lower energy prices coming through.

So I think, until we see third and fourth quarters, particularly that September, October, November period which has been very significant in the last three years, I think we are just noting that this is quite a good trend where it is today, but it would be very foolish to extrapolate it.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Douglas, thank you. Let me take a question from here in Hong Kong. Yes, please. The gentleman behind, then Roy, and then I will come back to you, if I may. Behind. All right, Roy, go ahead.

---

**Roy Ramos** - *Goldman Sachs - Analyst*

Thank you. Roy Ramos with Goldman Sachs. One quick follow-up question on HSBC Finance Household and then one question on the balance sheet management. Which, again, as you yourselves have noted, this is the first time in 11 quarters where provisions are running lower than charge-offs. To what extent should we assign significance to that? Or, as you said, are there still seasonality and technical factors involved or is this fundamentally the management being more confident about stabilization from here?

And then the other question I had was on page 22, where you had a very noticeable year-on-year and half-on-half swing in balance sheet management. I do not know if you could give us a bit more colour into that. You mentioned that part of it was positioning for lower rates, so presumably there is a one-off element in there, but I guess if you can give us a bit more colour in terms of what you have done on tender or risk appetite. And obviously we are trying to figure out how much is sustainable as an increase going forward. Thank you.



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Roy, thank you for that and I am going to turn this largely to my colleagues in London, Stuart in the case of the second question and Douglas, I guess, on the question of the impairment provisions versus the charge-offs in the Consumer Finance book.

Let me just briefly say, in the case of the balance sheet, we did put on a number of positions in the autumn of last year. They do partly offset the pressure on deposit margins. And yes, those run off in the latter part of this year.

But Stuart, let me ask you to pick up on that first and then we will come to the Consumer Finance question second.

**Stuart Gulliver** - *HSBC Holdings plc - Chief Executive, Global Banking & Markets*

Okay. Thank you, Stephen. The second half of 2008 had write-downs in it. It had write-downs of losses on Icelandic banks and various of the US banks that got into difficulty. So the second half number would actually have been higher, and therefore the jump into the first half is more pronounced because there were not similar write-downs in the first half.

It is also obviously the case that, in the US and the UK, the Central Banks reset interest rates close to the zero band. And it is also the case that there was the enormous injection of liquidity that went into the market, short-term rates became very low. We saw just last month the ECB come with a funding program of one-year money that was taken up to the tune of about EUR450b. So there is an element where we have seen substantial additional gains in balance sheet management.

Now, the positions were put on basically in 2007 and they are mostly two, three-year positions. So there are some maturities and there are positions that run off. However, the yield curve is actually a great deal steeper than it was, say, when we did the results back in March. And therefore, what would be correct to say is that the second half will be lower than the first half, but I do not think I can get into particular guidance without falling foul of Stock Exchange rules.

But I think the thing to stress is it is not the case that the entire book matures some time in the second half, and therefore this number falls completely dramatically. And we have been able to reload the positions, as yield curves have steepened up. And as I say, there was a pronounced depression, as it were, in the second half because of write-downs.

**Douglas Flint** - *HSBC Holdings plc - Group Finance Director*

I think, very quickly, Roy, in answering Robert's question, the trends were pointed out. Obviously, the stock of provisions at the end of the period is a function both of the current trends, the statistical requirements, extrapolating those trends, but also the size of the book. I think both in the run-down portfolio but also in the cards portfolio, the run-off has been very strong. So part of the movement in the stock of provisions is simply a reflection of the fact that we have a smaller book of business at the end of June.

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Douglas, thank you. Mike, do you want to take another question from London?

**John-Paul Crutchley** - *UBS - Analyst*

Morning, all. John-Paul Crutchley from UBS. Two quick questions, if I can. The first was just coming back to the US business, where the core portfolio, the card business, has actually shrunk faster than the non-core portfolios. Mike, you commented obviously that there has been a de-leveraging process going on there. There is obviously seasonality as well. I was wondering



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

if you can just comment on what the balance was between the two, just trying to think about what the ongoing run rate of that business is in terms of assets, when I think about probability going forward.

And the second quick question was just on the China businesses, where it looks like the core HSBC brand businesses have materially underperformed the associates in terms of reported numbers. And I wondered if you could just comment on what the trends are there. Sorry, I have not actually got to that part of the release yet. It is obviously fairly deeply buried into it. But if you could maybe just comment around what is happening in the China businesses, both the associates and the HSBC brand.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

John-Paul, thank you. Mike, do you want to comment on the US situation? Then I am going to take the China question at this end.

---

**Michael Geoghegan** - *HSBC Holdings plc - Group Chief Executive*

All right. The card business, as you will recall, is split 50% prime and store cards and 50% sub-prime. What we are seeing is a general run-off of credit in all areas. You are absolutely right in that there is a timing element too. But it goes back to my point before, is that the sub-prime is behaving better than the prime in regard to both us being proactive in regard to renegotiating store card contracts, etc., moving out of some of that business, running off the Metris portfolio, which was the near-prime portfolio, which has not being performed as well.

So, overall, if you ask me where did this business go, I think it is a reflection of the underlying economy. I do believe probably in the second half we will have to look at where we are in sub-prime. We have made it very clear we were not going to make a decision on the card business overall for two years, and that remains where I stand on it. But I certainly do - either for us or for somebody else, this is still a valuable business. It is got 36m active cards.

I think China, Stephen, is for you.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Yes. Mike, thank you. You are correct, John-Paul, the profit performance of the network was down on both the two previous halves. That is a little bit due to investment and expansion of the network, but largely due to compression of lending margins, in fact. Sandy, do you want to add anything?

---

**Sandy Flockhart** - *HSBC Holdings plc - CEO, HSBC Asia Pacific*

Compression on lending margins, obviously a drop-off also in terms of trade values, because not only in trade exports out of China but equally as well in terms of the value of commodities coming in, a dropdown there. And equally as well, in terms of what we earn on deposits, there was a significant drop there. And equally as well, in terms of international companies in China, a lot of paying down of their debt.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

It is certainly not a phenomenon that leads us to reappraise the value of investment in China in our own network. And we are going to continue apace with that, indeed expect and hope to have got to 100 outlets by the end of the year.

Mike, another question from London?



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

**Michael Geoghegan** - *HSBC Holdings plc - Group Chief Executive*

Question in the front row.

**Leigh Goodwin** - *Fox-Pitt Kelton - Analyst*

Thank you. Good morning. It is Leigh Goodwin from Fox-Pitt Kelton. Actually, I have got a couple of questions, if I may, one on GBM and the other on margins. My question on GBM is: Stuart, you kindly gave us some indication of where the balance sheet management revenues might go, how we might think about those. I wondered whether you could elaborate on some of the other items within the GBM performance. Obviously, extremely strong. How much of that is related to the steepening curve that we have seen and what the outlook might be?

My question on margins may relate, because I see the Group's net interest margin is up nicely. I just wondered what that would be without the balance sheet management contribution.

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Leigh, thank you. Obviously, Stuart, if you could take the first one and Douglas join in as you see fit, and indeed the second one may be between you two as well.

**Stuart Gulliver** - *HSBC Holdings plc - Chief Executive, Global Banking & Markets*

Okay. Thank you, Leigh. The total operating income for Global Banking & Markets was $12.2b, and balance sheet management was $3.2b of that, so it is only 25%, actually, of the total. And also, you should look at the fact that we have absorbed a headwind, or a negative variance, in security services, PCM, asset management and private equity of about $1.2b within those numbers.

So it is actually a very diversified book. So the extent to which you suddenly get inflation come back, apart from the benevolent impact that will have on PFS and CMB, it will also drive through enhanced performance in GTB, in payments and cash management and security services and asset management, etc. So, actually, there is diversification indeed within the Global Banking & Markets business.

But the BSM part is only a small part of it. We have seen a substantial pick-up in customer-related revenue. And the way we annualize this - and this is a broad assumption that Douglas would not recognize as a fully audited statement - but we see our business as being about two-thirds customer and about a third risk, including 80% of BSM as risk in that definition. So you can work back from that and take BSM out.

So, actually, it is reasonably sustainable. It is very diversified across 63 countries. We are one of the few international banks that now actually enables corporates who deal internationally across the world to connect those pieces up, and are perceived to be in business in 10 years' time, and are perceived to be in all those countries in 10 years' time.

So, actually, it is reasonably sustainable. The second quarter was higher than the first. July is looking pretty good. So, actually, we think that this is a reasonably sustainable business. The question mark is over the BSM, and I would not want to go back over the points I made to Roy. But the rest of it is going to turn on whether the economies are actually healing or not. But I think we are very well positioned to take, and have already taken, really quite significant additional market share in the markets we choose to compete in, which is basically Europe, Asia Pacific, Middle East and Latin America.



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

**Douglas Flint** - *HSBC Holdings plc - Group Finance Director*

Yes. I think, putting it simpler, I think in PFS and CMB, broadly speaking, the repricing of assets has been of a similar order to the give up of margin on the deposit side. But of course, we have got a much bigger deposit base than we have assets. So, by having that balance sheet strength which we are committed to, we are actually, on a comparative basis, slightly disadvantaged. Because the current interest rate environment is very attractive to over-lent banks; it is less attractive to those that have got an excess of deposits.

So, to answer your question, without balance sheet management, the margin would have clearly come down.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Douglas, thank you. Question from here. Yes, please.

---

**Sunil Garg** - *JP Morgan - Analyst*

Thanks. I am Sunil Garg from JP Morgan. Two quick questions. The first one is on Global Banking & Markets' costs. Stuart, if you could give us some colour on should we expect a spike in second half costs, in line with the revenues, as in the variable compensation? Is that accruing along with revenues in the first half?

And the second question is on AFS reserve releases. You have released about $4b in the first half. The expected loss guidance, I think page 40 in your presentation, is still the same as it was in December, when you reported numbers in March. Any colour on how we should look at the timing on AFS reserve releases from here? Thank you.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Yes, thanks. Stuart, over to you on both of those, please.

---

**Stuart Gulliver** - *HSBC Holdings plc - Chief Executive, Global Banking & Markets*

We have been accruing bonuses in line with the enhanced performance already, so the extent to which there is a true-up in the second half should not be material. And in fact, that really explains. We have been reducing underlying costs within the business, and the reason why costs jumped from the second half to the first half is actually additional bonus accruals.

So, in terms of will there be a massive catch-up, no, there will not. Will there be some true-up? Well, it depends on what the second half looks like. But we have been accruing in line with our increased revenues.

Now, on the AFS reserve, page 40, if I remember correctly, in this, 39, 40, we do still consider that the stress test is relevant. We still believe that this portfolio will have impairments of $2b to $2.5b '09/'10, and expected losses from those impairments of $600m to $800m. The $539m impairment in the first half reflects that $2b to $2.5b. The expected loss of $148m that we have seen in the first half trues up to that $600m to $800m expectation.

So there is nothing that has happened in the market in the first half that causes us to feel that we need to revisit that. So it continues to track as we told everyone, both at the March results and during the rights road show.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Stuart, thank you. Mike, another couple of questions from London.



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

**Michael Geoghegan** - *HSBC Holdings plc - Group Chief Executive*

The fourth row back, and then third row.

**Michael Helsby** - *Morgan Stanley - Analyst*

Thank you. It is Michael Helsby from Morgan Stanley. Sorry to harp on about it, but just on costs in GBM. Clearly, it was a huge swing factor for actually what was reported. I think, if you take out the improvement in the cost/income ratio there, then the rest of the Group has actually got a negative jaws profile. So I appreciate how -you are saying you have been accruing costs in line with the revenues, but it is quite clear that you do things differently, or appear to be doing things differently in GBM. So I was wondering if you could give us some more philosophy in terms of how we should think about that going forward, in terms of the costs.

And just one extra small thing on costs. I noticed there was about a $500m gain from an accounting change in the costs line. Is that just a one-off? And I have got a follow-up question on bad debts.

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Stuart, I think, first and then Douglas on the $500m gain.

**Stuart Gulliver** - *HSBC Holdings plc - Chief Executive, Global Banking & Markets*

I think you have to look at you have got to look at the income side of the cost/income ratio. There is a $6b increase in revenues, first half this year versus second half last year, and there is a $5b increase in revenues versus the first half of last year. So the story in the improvement of the cost/income ratio is not so much that we are managing our costs artificially down, but that our revenue has come through very, very strongly.

And we do not, unlike, say, yourselves, pay out 73% of our revenues or accrue 73% of our revenues. But I absolutely can say that we have accrued our bonus pool in line with the improved performance. We have a great team of people who have produced a superb result. Clearly, we are going to pay those people within whatever the industry standards are at the end of this year and whatever our competitor marketplace is doing at the end of this year, and we will continue to pay for performance. So there isno magic in the expense number. Actually, the driver is the revenue.

**Douglas Flint** - *HSBC Holdings plc - Group Finance Director*

And the accounting change, the $500m benefit in the European segment, is enormously complicated but it is absolutely a one-off.

**Michael Helsby** - *Morgan Stanley - Analyst*

And then I just had a question on bad debt. There is quite a big improvement in the bad debt in the commercial book in Hong Kong. We have been all reading about the boost to liquidity in the region. I was just wondering if you could give us some more colour in terms of what you would expect there. Should we expect that to be stepping back up in the second half of the year?

And also, in Asia Pacific and Latin America, there has been a continuation of the deterioration there. I was just wondering if you could give us more colour on what you are seeing on the ground and, again, whether we should expect that to carry on drifting up. Thank you.



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Michael, I think we will take that in Hong Kong, if I may. First, to make the obvious point that we are uncomfortable making forecasts of important lines in the account, like the impairment line. But with that forewarning, Sandy, would you like to talk about both Hong Kong and then rest of Asia?

---

**Sandy Flockhart** - *HSBC Holdings plc - CEO, HSBC Asia Pacific*

We have had an increase in loan impairment charges in Hong Kong in the first half, coming from a low base. And that has continued throughout the first six months. The other place where loan impairments on the commercial side picked up were obviously in India, where we had an increase there as well. On the PFS side, principally, the main areas where there have been increases would be Hong Kong, to a lesser extent, a small amount in Indonesia and an increase in impairments on the consumer book in PFS in India. That is the principal places where in the first half that happened. But generally speaking, that is from a low base, and we certainly think that we have got all these bases covered.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

And Mike, I do not know whether you want to add anything on the Latin American position, particularly Mexico and Brazil.

---

**Michael Geoghegan** - *HSBC Holdings plc - Group Chief Executive*

Yes, Stephen. You will recall we bought Banco Bital, which was a liability-driven business that di not have that significant number of assets. So we have been building the asset base of that, in particular in the card business. And there is no question we experienced some digestion issues with that. It is a broader-margin business than you see in developed markets. It will take some time to mature. But that is how a card business works. We will work through it.

In Brazil, payroll loans were not that successful in certain areas, but we are well into restructuring that part of the business. So I think, overall, it will be a reflection of the underlying economy where impairments go from here.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

There is one point I would add on (technical difficulty). A question from Hong Kong. Yes, please.

---

**Bill Stacey** - *Aviate Global - Analyst*

Bill Stacey from Aviate Global. My question is about the Private Bank. And I notice that in the half net new assets declined by $7b, whereas some competitors have actually seen improvements in net new assets. And I was wondering, what is the issue here? Is there any need to reposition your business in the US, given a number of changes there and obviously intense focus on private banking there? Is there any impact in the Asia business from things like the experience with accumulators, etc., that have had a focus locally? And what are the quarter-on-quarter trends there?

And I suppose, just very quickly, while I have the question, on IAS 32 and the draft changes that are there, how would you anticipate dealing with the elements of those proposed changes that are optional? And what are the key issues for HSBC in those proposed changes in IAS 32?

---



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Bill, thank you. -I am going to let Douglas answer the questions on IAS 32, you will not be surprised to hear. But on the Private Bank, we, as you mentioned, lost some net assets outflow. It is relatively modest and it is actually the first time. I do not think there is anything particularly significant in it, other than to say we have as a general policy not competed up for deposits in particular, because we have not had the need to do so. So I do not think there is anything that you should read into that that is in any way significant.

Douglas, over to you on IAS 32.

---

**Douglas Flint** - *HSBC Holdings plc - Group Finance Director*

Well, it is still work in progress. I think what you are referring to is the move from a three-bucket model to a two-bucket model and get rid of available for sale. I think, in principle, we are quite comfortable with that and we would see it as a simplification. The devil, as ever, is in the detail. And while the actual guts of the proposals can be encapsulated within about four pages, there then is about 80 or 100 pages of guidance.

And the big issue which will be the subject of consultation over the next few months is on the definition of basic loan features, as to whether you can accrual account or not accrual account. We will be heavily contributing to these debates, as we have done in the run-up to the proposals. But it is still very much work in progress, so I think we cannot really give you a proper response until we know what the final shape of the revisions is. But we welcome, in broad outline, the move to a simpler two-bucket model, as it were.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Douglas, thank you. Mike, any other questions from London?

---

**Sandy Chen** - *Panmure Gordon - Analyst*

Yes, hi. It is Sandy Chen from Panmure Gordon. Just one broad question and a tiny little specific question. Looking at Europe and the trends in delinquencies and impairments, how would you contrast that with what seems to be an improving picture in the US, especially given the slightly different flavor of government bail-out programs?

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Mike?

---

**Michael Geoghegan** - *HSBC Holdings plc - Group Chief Executive*

Firstly, let's look at Europe broadly, across all three businesses, PFS, CMB and Global Banking & Markets. And also, you need to look back, second half on first half, there were some fair value gains in the first half -- sorry, in the second half and not in the first half of 2009. And also, there was the sale of the French subsidiaries in the second half of 2008.

But generally, if I look at loan impairments, firstly, we are starting from a very low base. And you need to stand back and think what did HSBC do in late 2006, early 2007. We told you that there was a problem in the USA and we also went around making sure that our businesses across the world were prepared for the downturn.





©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

That, here in the UK, meant that we cut back on lending unsecured lending and we cut back on commercial real estate. In Europe, where we are not that large, our businesses were generally robust anyway. So where you are seeing the up-tick in trends is in unsecured lending here in the UK, to a low extent, from a low base, of about 1.46%. Clearly, during the period, there were a couple of charge-offs and provisions made for Global Banking & Markets individual client exposures, but overall our businesses there strong.

Commercial has actually, I believe, been very robust, far more robust than what we have seen from our competitors, again from a very low base. We have seen some deterioration in the UK, but significantly less than what we are hearing reported by others in the market.

But I think in the accounts, if you look, there is a breakdown of this on page 52, to give you some more guidance.

---

**Sandy Chen** - *Panmure Gordon - Analyst*

Yes. Thanks. And just the specific question was on the monoline exposures. That is gone down a bit, from about $12.4b down to $10.9b. Just given the fact that some of the monolines have been downgraded further and there might be some further underlying asset deterioration, would you expect that there would be further credit risk adjustments that you will be taking, second half?

---

**Stuart Gulliver** - *HSBC Holdings plc - Chief Executive, Global Banking & Markets*

Well, Douglas clearly is policing what I am doing here, so it is probably better to have the Finance Director talk about that.

---

**Douglas Flint** - *HSBC Holdings plc - Group Finance Director*

I think it is all set out in the impacts of market turmoil section. I think that the significant charges in the half were in respect of those monolines that were downgraded in the period. And obviously, the extent to which we rely on protection is done. The residual value that we place on protection offered by the monolines or protection purchased on the monolines is heavily concentrated on those that continue to be investment grade rated, and the level of value that we have given to the non-investment grade rated ones is very, very modest now.

Clearly, there are two moving pieces. One, what happens to the underlying net exposure, i.e. what is the mark-to-market on the underlying bonds - as you say, it is coming down - and whether that underlying exposure is supported by the better or the weaker monolines. I do not know. I think the downgrading in the first half of this year was broadly expected, and it is not impossible that we will see further downgrades at some point in the future. But it really just depends on what happens to the net exposure, because that obviously impacts what happens to the monolines.

Plus, as you know, there is a huge set of legal discussions going back and forward between some of the ways that they have restructured to their benefit or dis-benefit, depending on whose argument you are pursuing. So I think this is still very uncertain.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Douglas, thank you. Any questions from here? Yes, please.

---

**John Waddle** - *Mirae Asset Securities - Analyst*

Yes, hi. It is John Waddle from Mirae Asset Securities. A quick question on the HSBC Finance risk-weighted assets. Again, it is up to $190b. You are shrinking the book, but the risk-weighted assets keeps going up. Your Group capital is very strong, so is there



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

any incentive for you to try to dispose of those assets to free up capital? I know the unrealized or fair value would be a write-down, if you had to sell them, but when in your mind is there an incentive to do that?

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Well, I will let Douglas or Mike comment, but at the moment there is no real market, so I think it is somewhat of a theoretical question. Actually, we may well find that as and when the market is there we will look at whether there are opportunities that make sense. We may also conclude that these are rather good assets to own because, as you will see from our advance/deposit ratio, it is not as if we were long on assets.

But, Douglas, do you want to comment on the risk-weighted assets part of the question?

---

**Douglas Flint** - *HSBC Holdings plc - Group Finance Director*

Yes. This is pro-cyclicality, if you like. The risk-weighted assets are rising with a falling book largely because the quality of the assets is moving into, it is a more mature book with a higher proportion impaired or with a higher risk weighting to it. So the capital rose but a higher risk weighting, so that is why the risk-weighted assets are going up.

We continue to look at this business entirely on a discounted cash flow basis. Are we better running the business and collecting or are there individual portfolios that we can redeploy capital from by selling in the marketplace? Clearly, we would not sell the book at indicative fair values at the moment because we believe that to be significantly less than the cash flows discounted from running the book off, because what you would lose is clearly the spread from revenues over costs, which has actually been quite good in the first half of this year.

So we continue to run off. We look at individual portfolios. We actually sold a $4b portfolio out of the prime mortgage books largely because we could see the ability to redeploy capital and the modest loss that was made from that was seen to be perfectly reasonable, I guess, what we could see, from running it off ourselves. And in Consumer Finance, we still think we will do better for shareholders in running the book down.

---

**Michael Geoghegan** - *HSBC Holdings plc - Group Chief Executive*

Douglas, could I just add to that before? I think, if you go to page 64 of the presentation, what we are really saying about HSBC Finance core, its revenues are up 7%, first half on second half 2008, and the reason for that is that obviously the pricing of our liabilities, our funding has been offset, and much better than we envisaged.

But it is more than just that. Loan impairment charges are down 17%, but expenses are down 13% as well. So, all these ingredients, I think, just looking at a set of assets, you have got to look at the underlying trend in the business, the value of the business. Because, going to Stephen's point, with the US banking industry de-leveraging so rapidly and savings going up so quickly, yielding assets like these are going to have a significant value in the future, even if you are going to have to carry a risk-weighted asset basis for a period of time. The revenue up-tick is quite important.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Mike, another question from London.

---



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

**Ian Smillie** - *RBS - Analyst*

Thanks. It is Ian Smillie from RBS. You have been very clear that the Group ROE is positioned to benefit when interest rates go back up. The question is, from here, with the strong cost performance and the strong balance sheet management revenues built in, what incremental levers are you thinking about pulling to get the ROE up until short-term interest rates go back up? Or given the strength of the economic outlook, are you happy to sit and wait until that naturally flows through?

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

Yes. Ian, if I may, we have got a published target for the ROE of 15% to 19% through the cycle, and clearly that is where we believe that the Company should be able to perform over the medium and longer term. But this is not a short-term objective. It is not a short-term target. Our job, I believe, is to position the business so that we are in a position to take advantage of opportunities as they open up.

That is not just a general statement. It means specifically that in the context of the current financial and economic environment, and as the world economy begins to move out of recession, there will be opportunities to grow business, certainly organically. We want, as you have heard us on this before, to be able to look for sensible inorganic opportunities, but our main focus is organic. We believe that we have shown market share gains in Stuart's business, in Commercial Banking, in Retail Banking in the shape of the mortgages business, both here, in Hong Kong, and in the UK. These are all the sorts of things that we should be doing to grow the business.

If we do that on the basis of a very tight operating cost control and by presumption, if we are doing that against the background of impairments peaking because the economy is improving - that is not a forecast, but eventually that is clearly one of the implications of an improved economic environment - you have got substantial gearing that should enable the Company to perform strongly. And we do believe that it is possible to operate the Company over the cycle in that 15% to 19% range for return on equity.

Another question from London, perhaps? Mike?

---

**Michael Geoghegan** - *HSBC Holdings plc - Group Chief Executive*

Nothing here at the moment.

---

**Stephen Green** - *HSBC Holdings plc - Group Chairman*

More questions from Hong Kong? No questions from Hong Kong, either. Well, we have obviously exhausted you. Well, thank you very much for being with us. Thank you for your interest in HSBC. And we look forward to seeing you at the full year presentation, in early 2010. Thank you.

---



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

**DISCLAIMER**

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2009, Thomson Reuters. All Rights Reserved.



©2009 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.