Edited Transcript

Post-Annual Results 2014

Meeting with Analysts hosted by Iain Mackay, Group Finance Director

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Corporate participants:
Iain Mackay, Group Finance Director
Russell Picot, Group Chief Accounting Officer
Jane Leach, Head of Group Regulatory Reporting
Nick Collier, Head of Group Investor Relations

HSBC

Nick Collier, Head of Group Investor Relations

Welcome, everybody, to the post-results analysts' meeting. Before I hand over to Iain, Russell and Jane, just some housekeeping points as usual. The mic will go round to the questioners, so, if you could mention your name and firm, please. We do have some calls hooked in from the analyst community in Hong Kong, so we will take questions from there. The transcript will go up of this meeting, so there'll be full documentary evidence of this meeting. That will be up on the website as soon as we can get that through. So, without further ado, over to Iain. Thank you.

Iain Mackay, Group Finance Director

Thanks, Nick. Good morning, everybody. As I'm sure you can well imagine, the fourth quarter of last year was incredibly difficult from many perspectives and, to say the very least, the numbers were more than disappointing. I think from, certainly, Stuart's, myself and rest of the management team's perspective, there was good momentum coming in to the fourth quarter, but I'm afraid the fourth quarter was extraordinarily difficult. Very happy to go through, obviously, the detail of that with you, as well as any other questions that you've got on the year.

I think, just to give two minutes' worth of context around a great deal of media coverage around the Bank over the course of the last couple of weeks, Stuart and Douglas, as you probably know, are sitting in front of the Treasury Select Committee from 2.15 onwards today. I think they are both hopeful that (whether they're allowed to remains to be seen) it gives them the opportunity to talk a great deal about what we have done in the Swiss bank and the rest of the firm over the course of the last four years and more in terms of completely changing what the Swiss bank does, how it does it, which customers we trade with, how our relationship managers interact with them.

And there has been an extraordinarily overhaul of the Swiss bank over the last few years, and it's accelerated to a significant degree, certainly over the last two to three years, with a new management team in place, where we've recruited some particularly strong external expertise in private banking. An example of that is our CFO there, who was formerly the CFO of JP Morgan's private bank worldwide – a French gentleman called Christophe Guillemot – and he, as well as a number of other people that have been introduced to the Bank over the course of the last few years I think have done an extraordinary job in cleaning up what was a particularly disappointing and messy acquisition going back to the late 90s. Again, it doesn't necessarily impact – in actual fact, it doesn't impact – to a significant degree the numbers in the fourth quarter, but to the extent that I can answer, I'll be happy to take questions in that regard as well.

So, with that, happy to get started. Alastair, your hand was up first, so you go first.

Alastair Ryan, Bank of America Merrill Lynch

I wanted to start because I wanted to talk about the fourth quarter. I'm sure the discussion will broaden out. What happened in GBM, really? Because it's historically been a business with… Clearly, it's income is sensitive to the same things as the American banks experience but, in the fourth quarter, it was more impacted across quite a wide range of income drivers, and there wasn't a great deal of cost flex. So, what did you learn? Was it doing something the wrong way or was it taking more risk than you'd thought? Is it inherently riskier in a low-rate, flat environment?

Iain Mackay

Thanks, Alastair. In the fourth quarter, doing quarter over quarter, third over fourth of this year, total operating income was down $1.4 billion. The vast majority of that was within the Markets space. Within Markets, we had several accounting elements that contributed almost $500 million of that movement. These included the implementation of Funding Fair Value Adjustment, which accounted for $263 million. Within legacy credit, we had a correction to an effective interest-rate calculation that was a historic adjustment, a review of how we were amortising interest within the legacy credit book, and that was $124 million. Of that $1,373m, $1,327m sat in Markets. And all of the $500m that I just told you, sat in markets.

In the fourth quarter of 2013, we had $190 million worth of revaluation credits from equities which related to Madoff positions as we resolved legal matters relating to certain Madoff cases, and that reflected the Madoff security revaluations, which contributed to a positive variance on the upside in the fourth quarter of 2013.

In addition to that, we had a disappointing foreign-exchange performance. So, FX performance, quarter over quarter, was down about $200 million, and that was largely based on very, very significant movements against the US dollar and, notwithstanding the fact that we had taken – and this goes across a wider discussion, possibly, about capital that we'll go into later – notwithstanding the fact that we've hedged some of the structural FX positions that we've got, particularly as it relates to the sterling bloc, the moves in the fourth quarter from a foreign-exchange perspective had an adverse performance on our Foreign Exchange desk revenues. That represented about $220 million.

The rest of it fell within Rates and Credit, both of which had weak quarters. The main driver from a Rates perspective was largely driven by much lower levels of client activity, particularly within Europe, and particularly as it related to building uncertainty with respect to Greece and, increasingly, the impact from the oil and gas movements within the fourth quarter. From a Credit perspective, really we saw more of a weakness within the emerging markets. So, although, overall, the Asian businesses held up pretty well in the fourth quarter, in the Credit space it was a bit weaker. Overall, Credit held up reasonably well, but Rates and Foreign Exchange were the main contributors to the downside. And it goes back to macro elements that were going on within the economy, how we'd positioned the book ahead of that, and the downsides associated with it. It was not because the Bank was out taking higher risk and got on the wrong side of that risk; it was very much a reflection of positions that we had going through the quarter, much lower volumes coming through from a client perspective. Those are the main drivers. So, $1.3 billion down, of which nearly $500 million was driven by single, one-off items that we had coming through.

Alastair Ryan

Does that come back? Are those one-off events or does that require a balance-sheet and/or cost –

Iain Mackay

So, from an FFVA perspective, that Funding Fair Value Adjustment will come through on a day-to-day basis, so we'll see a movement, both positive and negative, so there'll be some volatility coming through both Credit and Rates as it relates to. That $263 million is the step of implementing it first off. The re-val, it's a one-off that's come in through the equities book. In terms of adjusting the SICs and SIVs portfolios, then no, that's one-off again. As it relates to performance within the business, what I can tell you is that January has looked like a very normal month for the first quarter, from an HSBC perspective, for the Markets business, for the banking businesses, for Commercial Banking and for Retail Banking and Wealth Management. So, January has performed very much in line with our expectations. October, actually, wasn't that bad. November and December were just… You could have wondered whether there was anybody on the third and fourth floor of this building. It was not good, the daily revenue flows. I can assure you there were a lot of people trying to figure out what to get done.

But no, in terms of a reversion to a more expected performance level in revenue terms – and, frankly, PBT terms as well – both for Global Banking and Markets and for the firm as a whole, January performed very much in line with expectations.

Chirantan Barua, Sanford Bernstein

One of the things that I've struggled with is your hedges on the capital. Both on the absolute capital side, on the core Tier 1, you've had big swings this year, and we're heading into a year where we expect a huge amount of FX uncertainty as well. So, it would be great to understand exactly: how do you hedge your absolute capital, your core Tier 1 ratio? Is it your sterling and euro bloc which is totally exposed? And what were the underlying movements in the $8bn that you took a hit on last year?

Iain Mackay

So, Samir and I, and Marc Moses, sat and had a conversation about this for an hour or so yesterday afternoon. At this point in time, there are three currency blocs which have a significant influence overall on the structural capital position – significant in terms of they're the largest. There is the euro bloc, the

sterling bloc and renminbi. It is very difficult, in our view, to hedge renminbi from an accounting perspective. You can clearly do economic hedging, and you have to form a view on where, clearly, renminbi is going from now. We've had a pretty good run of revaluation of renminbi over the course of the last few years. It was certainly very stable over the course of last year.

Is there a devaluation risk against the renminbi? That's a tough one. Samir, Marc and I are going to keep thinking that one through for a while. At present, we do not hedge specifically the structural FX position on the renminbi. Historically, we've done very little hedging of structural FX, because the structural FX position basically represents the capital ratio in a branch or in a subsidiary operating in those non-US-dollar currencies, with a balance sheet that is matched, from an asset and liability perspective, on a currency basis for the most part. Where there is a mismatch, it's on an underlying asset or liability position, which is usually hedged through markets anyway.

In the euro, our view for the moment is it isn't going further south. We see stasis around that. We have not hedged the euro position.

On sterling, we did hedge a relatively small component of the position last year. Of the movement in capital, the largest single – not the only, but the largest single – contributor to weakness in the capital ratio was the sterling bloc. So, what is now under consideration with Samir, Marc, myself and Stuart is whether we should hedge a larger portion of that. There's more to think about that. Clearly, the election isn't helping, right? You then have to form a view about how the election comes out. Now, there are different alternatives for hedging, right? You can just do forwards, you can put a collar in place, so you can lock in a band, so we could do more around that. So, Thierry, myself, Samir, Marc are thinking about that just now as we're working our way through the first quarter.

Generally speaking, we do not hedge the structural FX position. Last year, we took a different attitude to that with respect to sterling, but sterling only.

Chirantan Barua

And the exposure to sterling is purely because of the mismatch within the amount of capital that you have against the risk assets.

Iain Mackay

It's the heavily capitalised set of subsidiaries sitting underneath the UK Bank. The UK Bank holds the vast majority of our European operations in its entirety, and that's a different discussion, which, as you go into structural change in the UK, should we, in actual fact, be taking France, Germany, Malta and the rest of them and getting them out from underneath the UK Bank and putting them under a separate intermediary holding company and into holdings? We have done that in a lot of regions around the world. Not as part of the conduct work, but we've done a very significant restructuring of the legal entities within the Private Bank over the course of the last two or three years, which I think has improved visibility, but also just put a much cleaner structure in place around the ownership of the Private Bank. I think, as we do contemplate structural change within the UK Bank, then it's probably the right time to simply take the UK and separate out the continental European exposures and put them in a separate holding structure.

Raul Sinha, JP Morgan Cazenove

Firstly, on NPLs, I know everywhere your NPLs are going down, except in Asia. Pretty much every Asian market has seen high NPLs in Q4, and pretty much every emerging-market Asian bank that has stuck to the market and said, 'These are very specific issues – there's nothing to worry here.' Can you give us a little bit more colour in terms of the move in Q4? Because your impairment ratio did go up from 27 bps to 50 bps in the fourth quarter.

Iain Mackay

So, I'll start, and then Russell can pick up, because there's a number of things that we did from our approach to collective impairments, which, actually, is a piece of work that had continued over the second half of last year, and the impact of which we reflected in the fourth quarter, which actually had very little impact on the financials, but it was the result of work of looking at emergence periods across a broad range of portfolios across the world. As we aligned to a more consistent approach, what we had

was puts and takes within different businesses and regions but, in the round, it had very little financial impact in the quarter for the Group as a whole.

When you look at the credit-cost development in the fourth quarter, it was characterised, setting aside that small adjustment – the emergence periods in those portfolios – it was characterised by relatively large customer positions, many of which were in the news, that were either, in our view, in need of restructuring and, therefore, there was a very specific position taken based on the nature of the restructuring that was being done, or there was not a restructuring in hand but, based on events that had occurred, our view was that there was an impairment that had occurred and, therefore, we made provision for them, although restructuring or any loss has not yet been incurred – if you like, from an economic perspective, has not yet been incurred – although, from an accounting perspective, we think a loss is very probable.

That was made up of a couple of accounts in Latin American businesses, mostly in Brazil, and a couple of accounts in Asia, and I think one or two accounts in Europe. What the teams spent a great deal of time doing, driven along the road very capably by Russell and the Chief Accounting Officers around the world, and the Risk teams, was challenging the Risk teams on, 'Is this the beginning of something as a trend? Are we seeing an overall negative migration of credit quality through our internal credit-rating system? Or are we, in actual fact, dealing with idiosyncrasies within those specific institutions?' And when you sat down and went through the credit review and the write-up, it was very much about idiosyncratic elements happening within that industry, or not even within the industry but within that specific entity that had no obvious relationship to a wider industry trend.

So, in Asia, where there was an uptick because of those individually assessed loans, the conclusion that we reached was that it's not indicative. There is no evidence to suggest that this is the beginning of a progressive ramp-up in credit costs. We'll take another very, very sharp look at that as we work through the first quarter and form conclusions at the end, but we conduct these trend reviews through December into January, right up to the point that we publish the financials, and as of 10 days ago we weren't pulling anything out that would contradict what I've just said to you.

So, I think last year, when we sat down and talked about it, we were talking about LICs as a proportion of average loans and advances. We were sitting at 60 basis points last year, and we were going, 'Right, well, that or slightly less', and we ended up at no less than 40 basis points. We expected to see improved credit coming through the finance company runoff but, in terms of broad-based improvement across Europe, which was very marked within Commercial Banking particularly, and within Global Banking and Markets, there was some upside. What I would say is we do not expect surprises to the upside. We've reached a very low level of impairments in the finance-company runoff and I think credit costs in the regions and through the businesses which we're operating are at levels that are lower. Although I'm not going to give you a number, I can tell you that we'd planned for higher loan-impairment costs than we incurred in 2014 and in 2015.

Iain Mackay

Sorry, Russell, would you add anything?

Russell Picot

Maybe just a couple of reflections, Iain. I think we took a bit of a deep breath and looked at the collective quite closely around the world. We looked at the retail books pretty heavily in the previous year, so we took a much closer look at the corporate book. And as you all know, the regulatory focus on stress testing has an AQR component in the market, so we also brought together all those different elements, looked at, for example, ECB / EBA feedback in terms of what that was saying and other regulatory bodies around the world, put that into mix, took a good, hard look, tightened consistency around the world, so you'll see GBM nudge up a little bit – $100 or so, I think, that was sitting in Europe. That's a slight lengthening of the emergence period on the Global Banking book. But that's pretty much it.

The other area maybe just to touch on, Iain, is, over and above that, we took a pretty hard look at oil and gas at the year-end. It was definitely in the 'should we be in HSBC overlay' territory.

Iain Mackay

I think you and I had more conversations – you, Marc and I had more conversations – with the Audit Committee, with the Risk Committee, with the Board, amongst our own management teams, about our exposures to oil and gas than probably any other single topic –

Russell Picot

We took a pretty hard look at that. We went down to individual names, just checking. So, we've marked in the book; we've said about half a billion dollars of oil and gas-related exposures at the year-end were requiring close attention, but none of those were individual accounts needing provisioning.

Iain Mackay

And Marc and the team were doing, have completed but continue do, name-by-name-by-name reviews within the oil and gas sector, amongst others, as you would imagine, but they got special attention in the fourth quarter.

Raul Sinha

I guess the second question – apologies for the generic nature of this but how did you actually come up with the 10% ROE number? I get the mathematical –

Iain Mackay

That's a good question.

Raul Sinha

I get the mathematical re-basement down, but the point is: at some point, you've got to come to the conclusion that the returns generated by your various businesses are not enough, and you need to change the structure of the Group in terms of the businesses that you do fund with shareholders' equity.

Iain Mackay

It's a great question. It was mathematical, but let me go back to part of what's informing here. We always go back to our adjusted profit. So, we work – and perhaps you will call us delusional on this basis – but we work on the assumption that, given the amount of work we are doing in operational risk, in conduct, in compliance, in sales-force effectiveness and product suitability that, at some point we get these one-offs around PPI, interest-rate derivatives, Consumer Credit Act – you name it – behind us, as well as FX and so on and so forth. So, we're working on an adjusted basis, and we're working on an adjusted basis and we look at the profitability of each business as it's running today, based on risk-weighted assets, what we can project from a risk-weighted-asset-development perspective, what we can project from a revenue-generation and from a cost-management standpoint.

And when we look at the returns the individual businesses are generating, with a few exceptions, today, on an adjusted basis, we can look at most of, but not all of, Retail Banking and Wealth Management and say, 'That more or less works at levels of return that are superior to that which we need to accomplish the 10%.' We can look at CMB and look at most, but not all – there are pockets within CMB in the rest of Asia Pacific – not Hong Kong, to be clear, but in some of the smaller markets in the rest of Asia Pacific – where Simon and the team need to do more work on capital management. Private Bank, for these purposes, is sort of a non-issue because they've next to no risk-weighted assets and it's a very low-capital-intensity business.

Global Banking and Markets, excluding legacy credit, which is all in London, we all know it's a low return on capital asset base, which is why there's an ever-increasing focus on getting that book run down on an accelerated basis, there are elements within Global Banking and Markets where Samir and the team are intensely focused – and will remain intensely focused, because Stuart ensures that they are –and this was the case in 2014; it will be the case in '15, '16 and '17 – where there is a need to reduce the capital intensity of that business and improve the pricing and performance and the efficiency of how that business – or certain lines of business within that – operate.

So, therefore, Global Banking and Markets today is structurally running a little bit below what we need it to be able to do to accomplish it's capital-return targets that we've set for it internally. It's not enormously below it, but it's somewhat below it. What that connotes, from Samir's perspective, is continuing to improve the capital efficiency of the business and look at each product line within that business, and form a view as to whether or not, in a longer-term perspective, either with regulatory development as it relates to capital intensity within that business and other aspects of regulation, whether we can improve it progressively over time to generate those returns and, if we can't, then there are more drastic actions required. I won't go into what those drastic actions require, but you don't need to extend your imagination too far to figure out what those might be.

Just as the applies to Global Banking and Markets, it also applies to components within Retail Bank and components within Commercial Bank that aren't working as well as they should. Now, a great deal of what's been informed by what we've done for the last four years around disposing of businesses has been just that same thing: are they connected? Do they sit in markets that represent growth? But there as a big component of it: does it contribute to future profitability? The only one that was disposed of that did contribute to profitability but didn't tick the box in any other regard was Cards in the United States.

Some of those businesses sit within the four markets that Stuart talked about a little bit more specifically on Monday. The focus is on improving the performance in those businesses, and there are very significant and drastic actions being taken by the management teams within those businesses, in which we've got the fullest of confidence and we're going to give them time to work that through. If there are certain product lines within those businesses, within those geographies, which we reach a point where we can't conclude, then more drastic action is available, but that's the nature of what we're talking about. We're committed to those markets and we're supporting the teams to turn it around.

But when you look at, specifically, for example, Mexico and Brazil, there were very, very definitive and determined de-risking and repositioning actions taken by businesses within that market. They were not intended to specifically reduce the revenue base, but some of the consequences of that repositioning and de-risking did reduce the revenue base. Where the team is now focused – and, actually, the Mexican team has done a great job on this in 2014 and they've got some momentum – is they did a very good job of managing their cost base in 2014 and they're beginning to build momentum around getting the revenues back into better shape. So, we've been monitoring them, literally every two weeks, very closely now for the better part of, probably, six or seven months of the year, with very specific metrics around what those businesses need to do in line with the plans that they've set out, and they're making progress.

But in fairness, each of the Brazilian and Mexican businesses have got a bit of a long haul, and the US, as we all know, I think the US team is doing a fabulous job but they've got a lot of stuff to deal with. The US market, to be clear, is one that we are fundamentally, absolutely committed to, but what we will continue to do with that business is continue to look at the individual product lines and make sure they meet profitability targets. And if they don't, then more drastic action is required within those product lines.

So, when we do all that mathematics, we've looked at it from each of the global businesses by geography and said… Because you looked at 12-15, and you look at what we anticipate, we don't know. So, when you go back to the 12-13, we may never end up at 12-13 from a regulatory perspective, but what we are planning for is that's where we're going to end up. If regulation doesn't take us there, we won't go there, but that's what we're planning for.

Raul Sinha

I guess the point I'm trying to make is there are businesses that will make a 12-15% return on equity on a 12-13% capital ratio and, effectively, what regulators are forcing you to do is to get rid of businesses that can't make that return with a high capital base, and it doesn't seem to us that that decision has been taken yet.

Iain Mackay

It hasn't because… I think you've got to take our view, and you can damn us for this if you like, but our view is you've got to take a longer-term view. There are lines of business that regulation presently would suggest that you should just be done with it and close it down. I think that's an incredibly short-term view. I think there are consequences politically and at a macroeconomic level of not providing those services to

a client base that needs them. And there's a wider issue here of where regulation conceivably ultimately takes us, and our view is that we've got to run those businesses as efficiently as we can and we've got to form a longer-term view about the viability of that business. What we are very disinclined to do is take a kneejerk reaction because of a particular piece of regulation which, as we all know, some of it's very well-developed and thought out and some of it isn't. And I think we've got to continue to engage with the regulators around the world – but, frankly, what we're talking about is the PRA here – and continue to make the case why it's important that some of those businesses are conducted within the regulated space as opposed to the non-regulated space.

But what I know Stuart was saying on Monday was we will continue to take those actions and we will form a longer-term view, and if that longer-term view takes us to the point that it is not viable in the longer term and we cannot influence an outcome from a regulatory perspective, then we'll take the necessary action to address it. But what we have inside this firm are businesses that generate returns on equity of greater than 12-15%. You can look at the Hong Kong business, whether it's Hang Seng or whether it's HBAP, and it does well. You can look at the business in Canada: the Canadian business does really well. You can look at businesses in the Middle East that do well.

The UK business, you've got to look really hard. The UK business, when you carve out all the crap, is a good business. We think parts of that business will still be good after structural reform, parts that probably won't be, and parts that, conceivably, will not be done in the UK. Now, some of that depends on what happens at the election and what happens with a referendum, conceivably.

But the reason we came to 10% is, as a Group offering the services that our customers need and want across the network, we took the view that, although we can see certain businesses within the Group that can achieve those higher returns at higher levels of capital, there are some that can't. We view our cost of equity at between 9 and 10%. We look at the generating profitability of the businesses today, ex-legacy, on an adjusted basis, and with work – and we do need to work; this is not an easy target to accomplish – with work, we will get the Group to greater than 10%. And by the way, we didn't say 10%; we said greater than 10%. We're not going to settle for 10. If we can get it to 10, we will keep pushing until we get it to higher returns. But I do think our targets – we all think our targets – need to be credible and, from our view, from a Group perspective, we didn't believe the 12-15% was still credible, recognising that the capital requirements today are higher than they were when we set that target in 2011. So, we're trying to be, frankly – and maybe damn us for this as well – we're trying to be candid and forthright about what we think the Group can and should accomplish over the medium term.

Iain Mackay

If we keep going, we might just be able to avoid Tom the whole meeting, actually, because I know exactly what he's going to ask me as well.

Manus Costello

I'm not going to ask about capital.

Iain Mackay

There's a challenge for him.

Manus Costello

I'll leave the capital question to Tom.

Iain Mackay

Well, no, please feel free: ask a capital question.

Manus Costello

I just wanted to follow up on those comments around the restructuring, because I had a couple of knock-on thoughts from it. When you gave us the rather unexpected $38 billion cost target for 2018, does that include some of those restructuring measures that you're talking about? Because I struggle to get my model to $38 billion.

Iain Mackay

On an adjusted basis, Manus.

Manus Costello

Understood.

Iain Mackay

So, the $38 billion – and when you go through our adjusted basis, it excludes restructuring.

Manus Costello

I struggle to get it there in 2018, given that I would assume some growth in some of the Asian businesses, for example.

Iain Mackay

As we work through what we have to do in the cost space, here are the things we reflect on: 1) what we know we've delivered over the last four years in terms of sustainable saves. Since Andy Maguire joined us, we've sat down with a fresh pair of eyes – and this is absolutely not a critique of what Sean O'Sullivan did; Sean did some absolutely fabulous work before he retired – but we sat down with a fresh set of eyes and looked at the operating capability of some of our businesses, our core processes and our functions, and said, 'Forget targets. Forget some aspirational what we need to do. Just think about what we could do with what we're facing today.' And we've analysed this every which way from Sunday over the course of the last four or five months, and we keep coming back to a number which sort of falls in the $5-6 billion of sustainable saves, and that's not the right thing to call it: saves that we can get out of these businesses. Out of the businesses, the functions and the core operations of the Group.

What we know we need to do – and it would be lovely to take that to the bottom line – but what we know we've got to deal with over the next three to four years is UK structural change. What we know we've got to deal with is the restructuring of some of the businesses that sit within the portfolio today, regardless of their financial performance. There are businesses that are performing well that we know we've got to continue to make changes in to make them better. There are businesses that are performing to a substandard level, which, as they make progress, we may well conclude that there is a wider restructuring that is required, and we will contemplate that. And when we get clarity about what that restructuring may need to be, you'll see the numbers either as they come through the financials or as we're ready to take them through the financials, but you know the rules around restructuring.

So, in that $38 billion, there could be, on top of that – there almost certainly will be, on top of that – over the next three years, some restructuring charges. There will clearly be investment – and I have difficulty uttering that word in the context of structural change in the UK – but there will be spend on structural change in the United Kingdom, which will not be insignificant. And we know, based simply on what we know we need to do to meet the requirements of the DPA, which is a five-year programme which takes us through to the end of 2017, we get recommendations from our monitor once every year. The team made great progress in 2014 in implementing the recommendations that we got from the monitor last year. We got more – fewer, thankfully, but we got more – recommendations this year from the monitor, and the focus will be on delivering that on 2015 and '16 and '17, as we work that monitorship to conclusion. And we've got an investment and spend profile within that regulatory programmes and compliance space that is mapped out not over the three years but over a five-year horizon, and what we see is a continued need for investment and build over the next three years.

And beyond that, what we see are efficiencies coming through to the technology that we're employing, and the initial upfront investment beginning to tail off. And it's that, in the round, along with investment and stress-testing capability, investment in regulatory management, investment in improving the capital efficiency and product capability of the businesses, as well as fighting off inflation. So, you can build a stack of things that we have to offset, and that's another way that we've gone at this: what do we need to offset? What's our economy propensity within our businesses and functions and operations? Do those stack up and do we have a reasonable fighting chance of getting to a $38 billion run rate as we exit 2017,

going into 2018, so that we could deliver in '18 a cost base that looks similar in nominal terms to what we closed out in 2014.

Manus Costello

To be clear, that doesn't then include Samir shutting down bits of GBM or any of the other stuff you just talked about.

Iain Mackay

It does not at this point in time, no. It does not.

Manus Costello

If that's the case, it's a pretty punchy target relative to what I can see from consensus. Why did you give it on the conference call rather than put it down as one of your KPIs? Because it's a pretty powerful investment message.

Iain Mackay

It's a fair question. We're conscious of the fact that we put out a set of targets in 2011, the majority of which we've missed. The only one that we've really exceeded is capital generation, and capital generation is no longer a target for us. It's set by the regulators. This was discussed in detail with the Board and we all had a shared view on this: that we should focus on fundamentally what we believe matters to the shareholder, which is a return on the equity invested by those shareholders, the ability to grow dividends in line with the profitability, based on a set of regulatory capital assumptions, so a progressive dividend.

One of the operational factors that contributes to that is being able to grow revenues – if you can grow revenues, managing your costs within the confines of that revenue growth; if you cannot, managing your costs within the confines of what you can. That is why we put positive jaws in there. We know what we can execute internally, but what we have experienced for the last four years are things that we cannot control. However, we have to deal with them for the long-term wellbeing of the firm. As a management team, that gets put in front of us by our own management team, by the Board and by regulators. We have to deal with that and then adjust what we do from an investment and spend perspective on our propensity to generate revenues within the Firm. It is a punchy target; none of the targets we have out there are particularly easy to accomplish. I was somewhat surprised by some of the commentary over the last few days about 10% being an easy number. On an adjusted basis, we are operating in the middle eights right now. We have to add 150 basis points just to get to 10, and 10 is not really an aspiration. We want to be above 10.

To try to keep this focused, what we have seen is some perverse incentives around the cost-efficiency ratio. Frankly, the cost-efficiency is not the best indicator of the long-term propensity to manage the Firm, whereas positive jaws puts it right on the back of the business managers. We will go to Simon Cooper and say, 'If you can only grow your revenues by three, you cannot increase your cost base by five; you cannot do it. You cannot afford it; there is not enough money in the bank account. Sort it out. Go and deal with it. That means you have to come back to the functional owners, like Andy Maguire, me, Marc Moses, Chris Clark and say, "Guys, I cannot afford it. You now need to help it."'

That is what each of the global functions are focused on, because they obviously do not have a revenue target, but they do have cost-saving targets – and they have had each of the last four years.

Manus Costello

I have one final question following up on the comment about progressive dividend. If you do move into the world where you start knocking out some of those geographies or businesses, you have distributed or potentially distributed ex of scrip 9.6 billion last year. How then should I interpret your dividend guidance? Are you saying that the progressive element of it might come into question if that total number of profit starts to come down because of restructuring? You are moving away from the pay-out ratio target to progressive, in the context of a potentially lower total PBT number.

Iain Mackay

If you look at the board shape of the profitability of this Group, it gives you a pretty good idea of where the internal dividend flow is coming from. Stuart talked about some of the commercial banking businesses in the rest of Asia-Pacific sharpening their pencils. We talk about our businesses in Latin America and the US having to sharpen their pencils. No, it is more than sharpen their pencils: they have a lot of hard work in front of them and they are doing a good job, in my estimation, right now. Those legal entities where there are some branch-remitting surplus profits or subsidiary-remitting dividends – HBAP for example, which then remits dividends to the parent company – are not remitting enough.

Today, the big remitters of dividends to the Group are, as you would expect, the big profit pools. The restructuring in the big profit pools is around the edges in terms of improving the profitability of the business, and that is where the focus is. There are businesses today – and I am not going to name any of them, because it would be unfair to do so – where we could amputate them right now, float them away and then would have absolutely no impact on my ability to pay dividends to the shareholder whatsoever – none. The simple fact is they do not remit surplus profits. They wash their faces; they self-capitalise, but they do not remit surplus profits – and they do not pay dividends. The focus from a capital-management perspective, whether it is [inaudible] on my team or the CFO of every single legal entity and the CEO of every single legal entity, guys, if you think you can live without remitting profits to the parent company, think again. I do not care if you are the smallest business in the Group: you have to be able to pay us a dividend. Today, frankly, I could amputate quite a few businesses and have no impact on our ability to pay dividends.

Yes, Tom. You have to pay the piper eventually.

Tom Rayner, Exane

I do not know where to start, really.

Iain Mackay

Pick one question – how about that?

Tom Rayner

I will have two, then, if that is alright. That is less than normal. I will just follow on from Manus on cost. Stuart has talked about the underlying cost growth of 2%, which is before any investment at all. Obviously, that would get you to over 41 billion by 2018.

Iain Mackay

Are you trying to back into a revenue target here, Tom?

Tom Rayner

No, I am not. I am trying to understand how you can possibly think you can achieve 38 billion by 2018, because it looks like you need another net savings programme equivalent to the one you are halfway your moving towards the end of in order to get you there just with the underlying – ignoring any investment. I just cannot conceptualise how you can get to flat by 2018, unless you are going to downsize the business by selling things.

Iain Mackay

It is a challenging target. Andy Maguire is busy running an off-site with all of the COOs right now, but if Andy were to come in here and sit down and answer your question, he and I would be absolutely joined at the hip on the fact that we fundamentally believe that we see within the Firm a propensity to generate the same magnitude of savings as we have generated over the last four years. That number is a shade over 6 billion. We have to do this.

Tom Rayner

How?

Iain Mackay

What have we done over the last six years? We have fundamentally reorganised how the Firm is run. That was informed about control and extracting economies of scale when, in actual fact, we had diseconomies of scale because of how the Firm was managed.

Tom RaynerIf you were cynical, you would say you have done the easy stuff. I am not cynical, but the obvious stuff has been largely done by the plan and the update. You now have to find incremental things that you did not think of initially. It is a bit harder.

Iain Mackay

Many of my colleagues around the world would curse me if I were to say I have done the easy stuff.

Tom Rayner

No, I know.

Iain Mackay

We have done some of the easy stuff, but we have also done some pretty difficult things as well. The full benefit of some of those difficult things is not coming through yet; there is more to come. Some of the things we are now working on will be more difficult to do. I will give you one example that Andy is focused on right now. Again, this was a discussion with our Board last Friday. We have done a good job of building operating centres of excellence around the world over the course of more than the last four years, because this is a piece of work that started quite a number of years before that. When Andy and I looked at that – with not an entirely fresh set of eyes, because a number of us have known this for a long time – we are still running the same processes or what are supposed to be the same processes in multiple locations. You are not really getting that factory benefit. Because we are not running them through the same factory, they are not actually the same processes. When you now look at the geographic footprint and the real estate involved in that, Andy looks at the real estate portfolio and says, 'More money can come out of this.' If you then look at the process and the efficiency benefits that come from that industrialisation, if you like, there is even more that comes out of it.

One of the examples we have used for the last couple of years, which I still have a good laugh about at a very personal level, is the UK mortgage process. In fairness, it has improved enormously over the last three years. I did a mortgage when I moved back here four years ago and I did another two years ago. The experience between the first and the second was night and day. The second was still rubbish, but it was still night and day. When you then look at that process and say, 'How can we continue to improve this?' This is something that not just Andy is focused on; John Flint is intensely focused on this, because it is a core product offering for the bank around the world. If you compare how we do that in Hong Kong versus how we do that in the UK, it is chalk and cheese. There are some very, very simple things that need to be built on what has already been done to improve the industrialisation and efficiency of those processes, part of which takes cost out for us, part of which makes the customer experience a million times better. That is just one example, but I have absolute faith in the fact that we have 6 billion out there that we can get. Getting it is really hard work.

The uncontrollable factors within this challenge – which is why we think it is a challenge – is the fact that we have a five-year monitorship that we are dealing with; we have ongoing regulatory issues. I am not talking about capital or TLAC; what I am talking about is the cost of implementing processes to support it. If you look at what Russell and Mark and our Risk teams had to do last year on PRA/EBA stress testing – they are two out of 65 stress tests that we did for regulators last year – it is staggering. It requires industrialisation on a grand scale. When you look at the regulatory reporting that we do, it requires industrialisation on a grand scale. In front of you, you have financial reporting on industrialisation on a grand scale. The improvements that have been realised in getting this thing out over the last 5-6 years are unbelievable. The team has done a great job. The damn thing is still more than 400 pages long, but the efficiency with which it has been done is huge.

However, those are the kinds of things we need to keep doing – but none of it is particularly easy. It creates stress for the team, but we have to do this. We have done it for four years, which gives us faith that we can.

Tom Rayner

I will move on to the capital issue.

Iain Mackay

Was that not your one question over?

Tom Rayner

I will slip in a second. There is RWA inflation. I know that things have not had all of the 'i's dotted and 't's crossed.

Iain Mackay

Far from it, yes.

Tom Rayner

It looks like operational risk and market risk are pretty much agreed, which are going to add $100 billion to your RWA base, I would suggest, and maybe even more like $120-130 billion. When you talk about 12-13, are you also factoring in potential RWA inflation or would you think of that as really on today's risk weightings? If you did see inflation because of these new initiatives coming through, might that then scale down so the actual capital required in the business would be similar? Going back to Raul's point, when do you get to the end of the line, where all of these decisions and discussions with regulators have ended and you look at the business and you cannot make it wash its face in terms of cost of equity – and therefore the choice is to sell it or shut it?

Iain Mackay

There is a timing element, specifically on risk-weighted assets. When you look at the increase in risk-weighted assets in 2014, as you would imagine there are many moving parts. The single largest component of the movement was the implementation of CRD4 and the implementation of LGD floors across a range of portfolios by the PRA on our book globally, on certain portfolios. Growth is the other main factor, but there were lots of actions taken by a capital management perspective by Global Banking and Markets in particular – but other businesses as well. There was a great deal of work around model approval and review with the PRA and other regulators to prove the quality of the modelling that we do, bringing more recent data in and bringing more granular data in, which certainly built my confidence in the business's ability to manage capital more proactively from a credit and from a market-risk perspective.

I do think recent events probably up the ante – it is certainly an area of focus by our main regulator – in terms of operational risk. As we consult on something like the PRA buffer, which is out there right now, there is risk as regards that Pillar 2B element, which we cannot disclose and we do not know what that might look like future. I am not sure we recognise the numbers you have written up, Tom – at all.

Tom Rayner

You used to say that about 12 to13 as well, I remember.

Iain Mackay

Yes, but I am still saying we hope we do not get to 12 to 13. If we do not need to go there, we will not go there – to be absolutely clear. By the way, if you have a conversation with the PRA, they are not saying that is where we need to go.

Where I think there is greater risk is something like the revised standardised approach the Basel committee is focused on. We do not know what that is. The QIS that is out there just now is demanding a massive amount of data, which I think is appropriate. The timelines to provide that are completely unrealistic; we are very engaged with Andrew and his teams at the PRA in terms of coming up with

pragmatic approaches to helping them – because, in fairness to the PRA, they look at those proposals and they are not happy with all elements of them.

One of the bizarre things that come out of that is that the intent is not to increase capital requirements, but when you look at what is proposed you say, 'Right, forget it. Of course they are going to do that. If implemented as currently proposed, it is going to increase capital requirements.' However, within the construct of HSBC – and, I assume, more widely in the industry – there are elements of that proposal, as it would apply to certain parts of our balance sheet, that do not make sense. They are just not rational, and it is in those areas that we will focus most of our attention.

However, if we are not successful in getting pragmatic outcomes to that, what it absolutely connotes is amputation of those parts of the balance sheet. That is what it absolutely connotes. I am not talking about the fundamentals within the retail bank, the commercial bank, Global Banking and Markets or private bank; I am talking about components within that, which would not invalidate the banking model that we fundamentally believe in. It is important from the perspective of macroeconomic and economic support of capital flows and trade flows, but there are elements within our portfolio today that we would absolutely amputate. We do not see those requirements coming in before 2017; I believe we will get clarity about what they are well before they come in, which would allow us to take the actions necessary. However, we are absolutely firm with the view, as we have reviewed this with the Board in detail earlier this year, that if we had to do it we would do very, very invasive and fundamental surgery.

Tom Rayner

Thank you. That is an important point to conclude. Thank you.

Chintan Joshi

If I use the math Tom is using, you are going to be 41 billion. You want to get back to 38 billion. In an 8% cost reduction, 8% of the Group needs to be cut somewhere.

Iain Mackay

8% of what we do needs to be cut somewhere.

Chintan Joshi

Yes.

Iain Mackay

It could also be done better.

Chintan Joshi

I agree with you.

Iain Mackay

If we look at factories around the place, the biggest way and the easiest way – again, colleagues will critique me on this – to get to some of that is to stop doing some of what we do, because we have either believed it is required because somebody asked for it a million years ago and we have done it for a million years or because management is asking for things that do not drive the decision capability because it is a nice, warm and cosy comfort blanket. It is nonsense. Stop it; you do not use it; you do not need it. This is what matters in terms of driving the business. What we have to do is work with regulators around the world to deliver what they need more efficiently.

Chintan Joshi

If I start, 8.5% adjusted ROE at the moment, the point you made to Raul was there will be businesses where long-term profitability will need to be looked at rather than short-term profitability. I completely take that point.

Iain Mackay

You look at high cost-efficiency businesses and say, 'Does that work any longer?'

Chintan Joshi

If we assume some kind of redistribution of profits across various geographies and for tax, there will be 10% that needs chopping off even now – and even thinking about the long-term profitability. That probably offsets the cost inflation. Again, what is uncertain is how we think about that slide you showed us, which of course showed us the regulatory elements. How do we think about that bit on top? You were talking about 37.9 being actually 22.1, which is your actual underlying cost base. The remainder is pretty large and you are saying that is going higher in the near term before it goes lower. If you add up all of that, you will probably need at least 10% of the business to go – and then in the 90% you need to do things better. You have always anchored us with the cost/income ratio or something. How will you anchor us on costs in 2015/2016?

Iain Mackay

I mentioned something on Monday. We talked for the better part of the last 3-4 years about a quarterly run rate of between 8.6-9.2. We are now looking at a quarterly run rate which is 9.5, excluding the fourth quarter. That is how I would anchor you, on an adjusted basis; that is how I would anchor you.

Chintan Joshi

That is helpful, yes.

Iain Mackay

I am not sure. Again, as we work through the performance of the businesses, you might be right. With your analysis right now, we could take a few of our businesses and say, 'It is not worth it. Let us give up.' We are not prepared to do that, because we think in the longer term those business are important – for the net worth of the portfolio and the economic opportunity in those markets. You can look at some of our markets today and the economies and the politics in those economies are in a mess. However, when you look longer term, you could cast an eye forward five years and say, if we disposed of those businesses, we might say, 'I wish we had not sold them. I wish we had stuck it out, fixed it and built the capability.'

To be clear, even in those difficult markets, some of the businesses are working well. They have a good customer base; they generate good revenues, but there are things we need to do inside the businesses to fix them. I do not automatically go to the point of thinking that to get some of those cost savings we have to dispose of businesses. What we have to do is get better at what we do inside those businesses and functions that support them – and we've got to stop doing some of what we do.

Chintan Joshi

I take your point. Changing tack, on litigation, CCA is hopefully finished now.

Iain Mackay

That is a much easier topic. Ask me that question in July. Our legal counsel is busy with this. This is one of the most complex pieces of legislation. One of my favourite courses at university was law, and it would make your hair go curly, reading the CCA legislation. It is incredibly complex, but what we have committed to is doing a root-and-branch review of our compliance with the CCA. That is what the teams are doing. It is incredibly complex. The legal teams and the customer teams have come back and said, 'We need another few months to finish this off and be confident.' I think we have most of this behind us. Ask me that question again in July.

Chintan Joshi

In terms of Madoff, the language in the annual report has gotten a bit worse around Madoff.

Iain Mackay

No, there are just more cases. Again, there are a couple of these guys. We are getting to the statute of limitations in some jurisdictions which are trying to assert claims from a Madoff perspective. As you get closer to those statute of limitations, the legal cases are coming out of the woodwork. Again, I am not making a future prediction, but our counsel, both internal and external, has been extremely adept and successful at working through Madoff cases. It does not mean there is not risk, but they have a good track record of working through this. You are seeing more cases coming out as we approach the statute of limitation points.

Chintan Joshi

Are there any other litigation risks?

Iain Mackay

Anything out there is in note 40.

Chintan Joshi

What do we make of what is happening on the private banking side in terms of costs?

Iain Mackay

In note 40, we have expanded disclosure on the private bank.

Chintan Joshi

Have you put a number to it?

Iain Mackay

No, we cannot put a number to it. The Department of Justice has been going on for years. Again, the progress we have made on that and the degree of collaboration with the DoJ has been – I would love to think the Department of Justice would agree with this – absolutely first rate. Because of political influences now, I think it will be more difficult for our teams. Forget our teams: it will be more difficult for the DoJ to reach a wholly fact-based settlement on this than perhaps might otherwise have been the case. This is nothing other than by virtue of media coverage of an issue that is the better part of 10 years old, which the DoJ has been working with us on for the better part of four years now. The environment is going to make this more difficult. We see it. You've got investigators from the revenue department in India who are spending time in our offices. That is in the note. We have publicised cases in Belgium, France, Argentina, which is an interesting one, and obviously the DoJ in the US.

Our expectation is that, in the very, very best case, we are going to be employing more lawyers and spending more money on legal fees to defend ourselves in these cases. We will defend ourselves in these cases, but there will be higher costs associated in resolving them. What that is right now, we do not know.

We will have Sandy first and then we will have a question from Hong Kong.

Sandy Chen, Cenkos Securities

I have one tiny question and then one bigger question. The positive jaws guidance ends in 2015. There will be positive jaws in 2015, will there not?

Iain Mackay

That is our objective – on an adjusted basis.

Sandy Chen

I understand. In response to Tom's and Raul's questions, you talked a lot about RWAs and capital. I was looking at Pillar 3.

Iain Mackay

It is a great document, is it not?

Sandy Chen

It is lovely. I was wondering how the GEN2 models are going to bed in as the BCBS and IFRS expected loss methodology begin to converge more through the cycle on calculations of risk weights, RWA intensity and impairment charges. Could you talk a bit more about that both in terms of the effect on P&L and the risk weights?

Russell Picot

There are elements which have yet to settle, Sandy. You obviously have IFRS9; we have our IFRS9 project up and running, which we will deliver.

Iain Mackay

It is a cheap one to do, as well. Sorry, Russell.

Russell Picot

It is worth every penny, though.

Iain Mackay

It is absolutely worth every penny, yes.

Russell Picot

Internationally, the Basel committee is waiting for the US FASB to publish its standards. We do not have international convergence despite the long expressed views of the G20. They want convergence in this area. It does not look like we are going to get convergence, but it looks like we will get a different US standard. If that is where we end up, we will have most of the world on IFRS9 – i.e. Europe, Canada, Australia, most of Asia and the critical countries in Latin America – and the Americans on their own version.

The Basel committee needs to get that important lock in place. It will then need to think about what it will do with expected loss. At the moment, as you know, we take an adjustment for the 12 months expected loss over accounting impairment. The general expectation is, obviously, in IFRS9 land that there will be some increase in the level of accounting allowances held. What will they do with the expected loss adjustment? Will it be changed? Will it be pushed up? We do not know. There is a very important piece of policy work, which I think needs that US standard to lock before they can do it – otherwise they are going to do it in isolation with the US accounting scene, which is very uncertain. Then your guess is as good as ours as to what they will do.

It is not obvious, actually, Sandy, why a change of accounting means you suddenly have to have more capital.

Iain Mackay

It actually automatically generates it.

Russell Picot

However, I am used to operating in a world where such sentiment probably sometimes has to have a place.

Iain Mackay

Again, do not take this as a political comment; it is an observation that we see. There is a drive – by both the UK, in particular, and to only a slightly lesser extent the US – that just piling on more and more capital somehow makes the whole system work better – and it does not.

Russell Picot

There is an important link, because if you look at the Basel consultation paper and you think about applying floors and the expected losses on adjustment on the model book, if you are then going to say, 'Well, actually, those model RWAs are not enough; I am going to impose a standardised floor,' and you are still going to make the adjustment for the expected loss, you are piling yet more capital on. I think there is a very important piece of policy work making coherence out of this.

Iain Mackay

When you look at LGD floors, when we impose a higher and higher standard of capital efficiency performance and rigour on our businesses, they can look at an LGD floor and say, 'Any risk that we otherwise would have underwritten that sits below that loss given default floor, as you model it out, why would I do it because I cannot get remunerated for it?' The perverse incentive is that you can stop writing perfectly good credit to perfectly good customers who need that credit, because it is more difficult to remunerate it. If that is not a particular focus on financial exclusion, I do not know what is.

There is an aspect here of double-whammy. The regulators can look at it and say, 'That builds capital propensity.' However, I do not think the connection has been made intellectually about what that then results in terms of commercial behaviour. When we as a number of UK CFOs had that conversation at the PRA CFO meeting about a month ago, and they would absolutely refute that point of view.

John-Paul Crutchley, UBS

I have two questions. One is definitely a quick one and the other is perhaps slightly more structural. The first was actually just on CCAR in the US. I do not know if you can say anything about how you feel about that process this year relative to last year. Will that outcome have any material impact or not, given that obviously you are still subject to a DPA and a Monitor out there, too?

The second question is, as I said, slightly more structural. I am just trying to think about the cost of HSBC's domicile, its location in the UK. Clearly, we can see the direct cost: the bank levy and there is some stuff about ring fencing etc. However, is one of your problems not the fact that you are a very large balance-sheet bank in what is a relative medium-sized economy? How much does that impact on the underlying or implicit costs in terms of where the regulators want you to be in terms of capital ratios etc? When does that start to become a constraint on your business relative to some of your global peers?

Iain Mackay

To be clear, the headquarters could be anywhere and we would still pay a substantial share of the bank levy just by the scale of our business in the UK. Admittedly, almost 60% of the bank levy has got nothing to do with the UK business – or that would be a $600 million saving there. That is one direct cost that you can associate with headquarter location. Ring-fenced bank, you could be headquartered anywhere and we'd still be incurring significant costs in the UK – unless we decided that we just did not want to bank in the UK any longer – or not bank, do a fundamentally different kind of business.

To avoid those costs, you would basically have to say, 'We do not want to be part of the UK economy any longer.' When you look at the returns of the UK business, you have to carve out foreign exchange; you have to carve out PPI; and you have to carve out interest-rate derivatives, CCA and so on and so forth. However, when you do that, as we do every month, you have a business that is actually a good business that could be better and that's very much the focus of Antonio and the team. So the incremental cost goes to those aspects of PRA regulation which are not consistent with either the HKMA or the Federal Reserve or the OCC or the Monetary Authority of Singapore, and we've alluded to some of those aspects. The LGD floors is one aspect of that, and we know that's cost us several tens of billions of RWAs, so a couple of billion of capital – that's for sure – over the course of 2014.

The headquarters question is a complex one, and it's one that we discuss on a regular basis, frankly more out of frustration as opposed to out of: 'There's a clear solution; we pack up; we go somewhere else and all our problems are solved.' They're not, so it's a little bit of a red – red herring's not the right description, but it's an enjoyable distraction for Stuart and I from time to time, when we get really grumpy and like, 'Oh, let's just pack up and leave', but it doesn't solve… That's not really the driver here, so we have to focus on the individual components of the Group and make them operate better.

I think we have to do a much better job of making the case about all of the good things that HSBC does, not only in this economy but the economies around the world, whether it's the philanthropic work we do, which includes investment in building schools – I mean, one in the East End of London here. There is a huge amount of volunteerism; there's a huge amount of resources, not including the fact that we employ more than 40,000 people in this country and those people get paid salaries; those people pay taxes; those people consume in the economy, and, indirectly, we've got a huge number of those employees that do volunteerism in the country. There's so many good things that this firm and others do that apparently the politicians and the vast majority of the electorate don't really give a hoot about, and that behoves us to do a better job of communicating about what we do and the real value that we create in economies.

It's really difficult to do that when your CEO and your Chairman are sitting in front of the Treasury Select Committee, getting quizzed about things that went on in the Private Bank 10 years ago, which were not good, but, at the same time, why's it coming up now? Cynical comment – okay, let's move on.

Your first question on CCAR –

John-Paul Crutchley

How do you feel about CCAR?

Iain Mackay

How do I feel about CCAR? I feel very much about CCAR as I did about the PRA stress test. But, no, look, our US team, led by Gerard Mattia, has done an absolutely – god bless them, they've worked their tails off, but they've done a great job in building huge amounts of improvement in the process, and, to be clear, we passed DFAST, which is the quantitative element of this, with flying colours last year. We don't know what the Fed's stress will be, but I suspect we'll pass the DFAST this year as well. On the quality of the CCAR element, the teams have implemented massive improvements. I think we've got a pretty good chance of passing. I think, if we don't pass… Failing for a large American bank is almost existential, right? So you can imagine that Mike Corbat's feeling a under a little bit of pressure right now. God knows we want to pass; it's important to us to pass; it's important to restore our reputation in the US to pass, and we will do whatever it takes to get us to that point, and, even if we pass this year, we know that we've got more to do to build a qualitative appreciation of what we do.

I mean, people will come back and critique our capital management processes in the firm. I am of the firm conviction – I've been of this since the day I joined this place, at the end of 2007 – that I think one of the things this firm does better than anybody else in the world is manage our capital, but, when you need to put 15 tonnes of paper around explaining how you do that, which is basically what we have to do, then we have to do it well, and that's what we've got to continue doing. I think – you know, we've had no dividend distribution from the US since 2006 – 2007, let's say – 2007 definitively. Until we get past the DPA, I don't think we'll get dividend distribution out of the US.

I think having that capital there makes it easier to pass the DFAST, the quantitative component of it. It means that we have more than sufficient capital to continue to grow our Commercial Banking business and support internationally trading US enterprises through Global Banking and Markets and Commercial Banking. If, by some horrible outcome, we're not successful in CCAR, I don't think it impacts any of the capital actions that we do; I hope it doesn't impact any of the capital actions we have, like paying dividends and preferred shares, for example. It hasn't; it didn't last year. But what it does do is it absolutely takes the wind out of the sails of a team that's worked very, very hard. I think it creates a challenge for Pat and for Gerard and Stuart and myself to get the wind back into those sails and keep them going for another year, when I think, in their hearts of hearts, they know that as a firm what we're good at is managing our capital.

So I think the downside of failing is reputational. I think another downside of failing is that we're going to have to figure out how to blow a bunch of wind back into the sails of a team that's worked very hard to realise big improvements in what we've done.

Okay, so, look, thanks. Sorry we couldn't get all your questions. I know you interact with Nick and the IR team; continue to do so. We'll see some of you over the coming weeks. I'm sure we'll get a chance to

answer more questions. Thanks for your time, hugely appreciated, and enjoy the rest of the day. I'm sure I shall.

Forward-looking statements

This presentation and subsequent discussion may contain certain forward looking statements with respect to the financial condition, results of operations and business of the Group. These forward-looking statements represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Additional detailed information concerning important factors that could cause actual results to differ materially is available in the HSBC Holdings plc Annual Report and Accounts 2014. Past performance cannot be relied on as a guide to future performance.