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Rural Banking

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HSBC
The world's local bank

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All financial information used in this presentation is reported in accordance with IFRS and extracted from HSBC Holdings plc's 2009 Interim Report unless indicated otherwise. 'Hong Kong' includes Hang Seng Bank, 'Asia' includes Hong Kong and Rest of Asia and 'Asia-Pacific' includes Asia and the Middle East, unless stated otherwise.

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Market overview

Mainland China's rural areas are under-banked with huge growth potential

Rural market in mainland China[1]

2008	Mainland China	All rural areas[2]
Population (bn)	1.33	0.93
Area (sq km)	9,600,000	8,740,000
GDP (US$bn)[3]	4,331[3]	1,936[4]

- Approximately 70% of the Mainland's 1.3 billion people live in rural areas
- GDP of rural China contributes to 45% of the country's GDP, with an annual growth rate of over 10%[4]

Supportive government reform in rural areas

- To build a 'new socialist countryside'
- Rural economic development driven by preferential policies for the agricultural sector and rural financial institutions
- Relaxed market entry requirements for banks seeking to establish a presence in rural areas
  - In 2009 over 1,000 sites have been identified for rural finance reform, from 36 pilot sites in 2007 and approximately 100 in 2008

Notes:
(1) National Bureau of Statistics, local Bureaus of Statistics, local government websites, local China Banking Regulatory Commission offices, Chinese Academy of Social Science – Green Book of China's Rural Economy (2008-2009), 11th Five-Year Plan (2006-2010)
(2) 'Rural' is defined as all county level areas, including their urban centres
(3) HSBC Asian Economics 4Q09 (nominal GDP)
(4) Chinese Academy of Social Science estimates rural China contributes 44.7% of total GDP

Presence

First foreign bank to open rural banks

Pioneering venture

- Opened first foreign-owned rural bank in Dec 07
- Currently have 5 rural banks with 6 outlets – largest network among foreign banks
- Built on experience in risk management and operations to develop a tailored business model
- Combined customer base of about 2,700[1]
- Self-funding – tapping into high savings pool in rural China
- Over 200 staff[2]
- Strong government support for further expansion

Notes:
(1) As at end-Oct 09
(2) Includes staff in the rural banks and head office

Opportunity

Fast-growing market under-served

HSBC Rural Banks are well positioned to help further fuel the growth of the respective rural markets and take advantage of the under-served banking sectors

US$bn	HSBC Rural Bank sites	Suizhou Cengdu	Chongqing Dazu	Fujian Yongan	Beijing Miyun	Guangdong Enping
GDP	9.1	3.0	1.5	1.9	1.6	1.2
GDP growth	*12%*	*14%*	*17%*	*13%*	*10%*	*12%*
Deposits	9.2	2.7	1.1	1.2	2.8	1.5
Deposit growth	*21%*	*22%*	*25%*	*18%*	*17%*	*30%*
Lending	3.3	0.9	0.4	0.8	1.1	0.1
Lending growth	*4%*	*8%*	*20%*	*14%*	*-9%*	*14%*
A/D ratio	*36%*	*33%*	*34%*	*70%*	*41%*	*7%*

Note:
China Bureau of Statistics, local bureau of statistics, local government websites, local China Banking Regulatory Commission office; all figures as of 2008; growth figures are from 2007; assume current conversion rate of US$1=RMB6.8

Operating environment

Expertise, recruitment, regulations and systems

	HSBC initiatives to overcome challenges
Minimal industry expertise in rural banking	• Partnered with internationally renowned microfinance institutions to develop lending propositions for low income sectors • Built on experience in Suizhou and Dazu to develop products for SMEs and individuals
Lack of talent with rural banking know-how	• Boosted training on rural banking and on HSBC culture and systems • Launched talent management programme to fast-track development of a pool of professional managers
Rural bank set-up as separate entity with own capital base	• Standardised set-up across all rural banks to reduce cost, increase operational efficiency, manage fast business growth and ensure robust risk management and control
IT infrastructure not tailored to Chinese rural banking	• Enhanced systems to support Chinese language, local operational capabilities and adopt tighter controls to manage operating and credit risks

Strategy

Build sustainable and profitable model to capture rural banking potential

- **Bring expertise in process, product and technology to meet local needs**
- **Attract best talent and tailor training to local requirements**
- **Align culture and values to HSBC Group**
- **Deliver service excellence to all customer segments**
- **Bring the benefits of our global presence and connectivity**

Managing risk

Actively monitoring and managing operational and credit risks

Operational risk management

- **Systems and process** – Adapting HSBC IT systems and business processes to local market needs; maximising standardisation of processes and banking products to increase productivity and control, while decreasing cost and error
- **People** – Focusing on recruiting local staff; training and teaching HSBC best practice; identifying and developing career plans to retain top talent
- **Regulation** – Maintaining close contact with regulators to remain up-to-date on latest regulatory changes; proposing changes to regulations to facilitate sustainable growth of rural banking business
- **Audit** – Enforcing stringent oversight with regular external and internal audits conducted

Credit risk management

- **Expertise** – Leveraging best practice from around HSBC Group, academic researchers and external consultants
- **Pilot** – Rolling out products in a controlled manner: refining products and releasing controls slowly
- **Balanced growth** – Managing portfolio growth by actively diversifying risk
- **Strict credit control** – Ensuring parameters and systems in place to track and contain delinquencies

Delivering on strategy

Establish banks across rural China, then penetrate market in each location

"Broad, then deep" distribution strategy

- Strengthen profile
- Pre-empt competition
- Build up competency
- Expand current customer base
- Pilot key sectors
- Offset short-term financial implications with broader business objectives

Delivering on strategy

Developing tailored products and services

Pilot products and roll-out in phases

- Traditional SME lending is offered with greater flexibility on collateral
- Focus on agricultural sector lending across entire supply chain
  - "Corporate and farmer" supply chain lending leverages existing SME relationships and strong agri-supply chains in rural China
  - Unsecured individual lending
  - Farming association group lending
- Aim to cover key customer segments in remote as well as urban rural China
- Foreign exchange, trade finance and home mortgages piloted in 2009

Delivering on strategy

Building profile

Reputation for best practice

- Flexible, equitable and transparent lending models well received in our markets
- Good reputation for responsible and quality service
- Government endorsement on structured approach and initial success running rural banks
- Government invitation to open rural banks in designated sites

Delivering on strategy

Growing a sustainable business

HSBC Rural Bank lending by sector

Positive and growing performance

- Lending focused on agricultural sector
- Stringent credit policies
- Direct sales force and alternative mobile distribution channels to expand customer reach and liability and asset businesses
- Strong growth in deposits and advances; deposit-led business

Cengdu opportunity

Strong rural banking potential, few players

	Annual revenue or income	Number	Banking service providers[1]
SME	>US$735,000	~256	ICBC,ABC,BOC,CCB,RCCU
Small business	<US$735,000	~10,000	ICBC, ABC, RCCU PSBC
Rural individual	US$2,000 – US$6,500	~200,000	ABC, PSBC, RCCU

Note:
(1) List includes Industrial and Commercial Bank of China (ICBC) and Bank of China (BOC)

HSBC's first rural bank

- Located in Hubei Suizhou Cengdu
- GDP at US$3bn, up 15% per annum in the past 5 years from US$1.5bn
- Cengdu is relatively developed, benefiting from increased export volumes – primarily dried mushrooms
- Most of the 7 banks in Cengdu limit lending to the SME sector; only Agricultural Bank of China (ABC), Postal Savings Bank of China (PSBC) and Rural Credit Cooperative Union (RCCU) actively bank farmers and micro-enterprises
- The asset to deposit ratio of Cengdu county is 33% – below the national average of 67%

Cengdu opportunity

Cengdu banking market to grow to US$4bn in deposits and US$1.8bn in loans by 2012

Deposits outstanding in 2012[1]

Loans outstanding in 2012[1]

Rural individual ■ Urban individual ■ SME ■ Small businesses

Net interest income in 2012[1]

Notes:
(1) China Bureau of Statistics, People's Bank of China, Financial almanac, Booz Allen analysis, customer and competitor interviews.
(2) Assume conversion rate of 20%

Cengdu strategy

Drive business in pilot rural bank

Size	2008[1]
Population (Cengdu)	1.6 million
Number of banks (Suizhou)	7
Number of outlets (Suizhou)	222
Number of ATMs (Suizhou)	133

Note:
(1) Suizhou Statistical Yearbook (2009), China Banking Regulatory Commission – Suizhou Banking branch; banking data only available for Suizhou province (including Cengdu)

Strategy

- Open a minimum of 10 sub-branches/sales offices in Cengdu with 4 in full operation by end of 2009
- Target four customer segments – rural individuals, urban individuals, SMEs and small businesses
- Launch mobile vans to penetrate remote locations and promote brand and product awareness
- Mobilise a team of direct sales force to solicit deposits to fund steep loan growth
- Launch range of products and services, with ongoing enhancements

Case study: Corporate and farmer supply chain lending

Building on existing relationships and local knowledge

Lending to high-end farmers/suppliers with guarantee from an SME in the agri-supply chain

Local market condition	HSBC solution
Banks limit loans to the agricultural sector, preferring to lend to more stable industries in urban areas	Develop products tailored to harvest cycles and supply chain to support agricultural lending
Farmers have no credit history nor collateral – no access to financing	Build on farmers' longstanding relationships with creditworthy SMEs in their supply chain
SMEs often constrained as farmers are not able to expand their production size and quality of products	Provide working capital financing options, allowing farmers to scale production and improve output supplied to SMEs

Case study: Corporate and farmer supply chain lending

Farmer: Zhou Jin

- One of TongXing's largest suppliers – annual production of 50,000 chickens

Corporate: TongXing

- Cengdu's market leader in poultry and pork production and a leading SME in Suizhou
- Strong market position with robust financial history

- Corporate in poultry and pork production offers guarantee to farmer
- Farmer receives working capital loan of US$150,000 to expand existing chicken business
- Farmer pays back loan
- Farmer expands further into hog business and supplies both chickens and hogs to Corporate
- Farmer applies for second loan of US$250,000 to expand hog business, again guaranteed in full by Corporate

Case study: Individual lending

Applying best practice from an expert in small lending to rural communities

Non-collateralised lending proposition for working capital and fixed asset requirements

Local market condition	HSBC solution
Many consumer finance products, but limited lending propositions to support small working capital needs	Developed tailored lending products for rural China based on experience of Women's World Banking and other parts of the Group
Local banks focus on SMEs; difficult for smaller companies and farmers to obtain financing	Standardised criteria, loan size based on business strength and repayment capacity
Guarantee often required from government officials, larger associations or corporates	Accept guarantors from wide range of backgrounds
One-size-fits-all financial solutions	Repayment based on client's cash flow and business segment
Lengthy application process	Average turnaround time of 3-5 working days

Case study: Individual lending

Madam Lin Xiaoping's Pregnant Mother and Baby grocery shop

- Established shop in 2001
- Since 2006, doubled sales revenue year-on-year
- Applied for a US$15,000 loan to increase inventory and secure franchising charter
- HSBC issued a one-year loan 3 months ago
- Owner enjoys perfect monthly repayment record

- Lin Xiaoping says: "I am a business woman, running a small shop and I have limited connections with the government or big corporates. HSBC provided me with a loan quickly, based on my strong understanding of my business and proof that it could generate a good income."

Summary

Build a sustainable and profitable model to capture rural banking potential

- **Capture opportunity from changing regulations in an under-banked market with vast consumer and small business potential**
- **Build a sustainable rural banking business tailored to rural China, utilising local and international knowledge and Group expertise**
- **Optimise strong government relations – many local governments keen for HSBC to establish a rural bank in their pilot sites**
- **Invest in robust infrastructure and rural banking team to fast-track growth**
- **Stay focused on commitment to build rural banks – grow balance sheet, open new outlets, launch innovative products and strengthen brand**