Edited Transcript

Annual Results 2014

Presentation to Investors and Analysts

23 February 2015, 11.00am GMT

Corporate participants:
Douglas Flint, Group Chairman
Stuart Gulliver, Group Chief Executive
Iain Mackay, Group Finance Director

Douglas Flint, Group Chairman

Good morning from here in London and good afternoon to everyone in Hong Kong. Welcome to the 2014 HSBC Annual Results conference call. With me in London are Stuart Gulliver, the Group Chief Executive, and Iain Mackay, the Group Finance Director. Before we start, I'd like to say a word on behalf of the Board.

HSBC's performance in 2014 reflected another year of consolidation in the reshaping and strengthening of the Group, against the backdrop of geopolitical and economic challenges, particularly in the fourth quarter, most of which were unforeseen at the outset of the year. Unsurprisingly in this environment, revenue growth opportunities were strongest in our Asian business. Costs continued to increase globally, in large part to implement regulatory change and to enhance risk controls. It is clear now that societal regulatory and public policy expectations of our industry are changing its long-term cost structure.

Taking this financial performance together with the further progress made on reshaping the Group, responding to regulatory change and implementing global standards, the Board considers the executive management to have made good progress during 2014 towards strengthening HSBC's long-term competitive position.

The Group's capital strength and capital-generating capabilities enable the Board to approve a fourth interim ordinary dividend, in respect of 2014, of 20 cents per share, taking the total ordinary dividends in respect of the year to 50 cents per share, representing US$2.6 billion, $400 million higher than 2013. HSBC remains one of the highest dividend payers in the FTSE 100 and indeed the banking sector globally. I'll now hand you over to Stuart to talk through the key points, before Iain takes a more detailed look at performance.

Stuart Gulliver, Group CEO

2014 was a challenging year, in which we continued to work hard to improve business performance, while managing the impact of a higher operating cost base. Profits disappointed, although a tough fourth quarter masked some of the progress made over the preceding three quarters. In spite of this, there were a number of encouraging signs, particularly in Commercial Banking, Payments and Cash Management, and renminbi products and services.

Adjusted profit before tax, which excludes the year-on-year effects of foreign currency translation and significant items, was $22.8 billion, which is broadly unchanged on 2013. Reported profit before tax in 2014 was $18.7 billion, $3.9 billion lower than 2013.

Asia continued to provide a strong contribution to group profits. Middle East and North Africa delivered a record reported profit before tax. Together, Asia and the Middle East generated more than 70% of adjusted group profit before tax.

Commercial Banking also delivered a record reported tax, which is evidence of the successful execution of our strategy. This was driven by strong revenue growth, notably in our two home markets of Hong Kong and the UK. We also grew loans and advances to customers in Commercial Banking by 10%. Global Banking and Markets performed relatively well for the first three quarters of the year but, like much of the industry, suffered a poor fourth quarter. Revenue was lower in 2014, particularly in markets, but all other client-facing businesses delivered year-on-year growth. In Capital Financing, we increased our market share over the course of the year, notably in equity capital markets, debt capital markets, lending and advisory products. We were ranked number one for debt capital markets in the UK and Hong Kong, and number one for equity capital markets in Hong Kong. We were also named Global Bond House of the Year, Global Derivatives House of the Year and Asian Bond House of the Year in the International Financing Review Awards 2014.

Revenue was lower in Retail Banking and Wealth Management, primarily due to the continuing runoff of the CML portfolio in the US. However, in our Global Asset Management business, we continued our strategy of strengthening collaboration across our global businesses, which helped to attract net new money of $29 billion.

Global Private Banking continues to undergo a comprehensive overhaul, which has accelerated from 2011. As part of this overhaul, we are implementing tough financial crime, regulatory compliance and tax transparency measures. In order to achieve our desired business model and informed by our six filters process, we have also sold a number of businesses and customer portfolios, including assets in Japan, Panama and Luxembourg. The number of customer accounts in our Swiss private bank is now nearly 70% lower than at its peak. We continued to re-model the private bank in 2014, which includes the sale of a customer portfolio in Switzerland to LGT bank. One consequence of this remodelling was a reduction in revenue. We have also grown the parts of the business that fit our new model, attracting $14 billion of net new money in 2014, mostly through clients of Global Banking and Markets and Commercial Banking. In case there is any doubt, we have absolutely no appetite to do business with clients who are evading their taxes or who fail to meet our financial crime compliance standards.

At Group level, loan impairment charges were lower, reflecting the current economic environment and the changes made to our portfolio since 2011. Operating expenses were higher, due to increased regulatory and compliance costs, inflationary pressures and investment in strategic initiatives to support growth, primarily in Commercial Banking in Asia and Europe. Our balance sheet remains strong and we increased overall loans and advances by 7%.

In addition to the growth in loans and advances in Commercial Banking already mentioned, we notably increased lending in Global Banking and Markets in Asia by 14%. The Common Equity Tier 1 ratio on a transitional basis was 10.9%, and on the CRD IV end-point basis was 11.1%, at 31 December 2014. I will now hand over to Iain to go through the numbers in more detail.

Iain Mackay, Group Finance Director

As Stuart mentioned, reported profit before tax for 2014 was $18.7 billion compared to $22.6 billion in the prior year. This reflected lower gains from disposals and reclassifications, and the impact of other significant items, including fines, settlements, UK customer redress and associated provisions, totalling $3.7 billion.

We now use an adjusted, rather than underlying, measure to explain our pre-tax profit performance. This measure excludes the year-on-year effects of foreign currency translation differences and significant items. We've modified our approach to align it with the way we review our performance internally and following feedback from investors. Adjusted profit before tax for 2014 was $22.8 billion, broadly unchanged on 2013.

Looking at some key metrics, the reported return on average ordinary shareholder's equity was 7.3%. We're also disclosing our return on tangible equity for the first time, which was 8.5%. The main difference to average ordinary shareholder's equity is the exclusion of good will and intangibles, including present value in force of long-term insurance business. We'll disclose both ROE and ROTE in the future. Our cost efficiency ratio was 67.3% and advances deposit ratio was 72%.

Since we are using an adjusted measure for the first time, we've set out the adjusting items on this slide. Further details are included in the appendix. There's an increased negative effect from significant items in 2014, including fines, settlements, customer redress and associated provisions. Our 2014 figure includes: $1.3 billion in relation to UK customer redress programmes, including PPI; a charge of $1.2 billion in relation to ongoing investigations into foreign exchange, of which $809 million was recorded in the fourth quarter; a provision arising from the ongoing review of compliance with the Consumer Credit Act in the UK, of $632 million; and $550 million in relation to a settlement agreement with the Federal Housing Finance Agency in the US. Year on year, there's a reduced contribution from gains, disposals and reclassifications, offsetting the beneficial effect of gains on fair value of our own debt in 2013. Overall, the impact of these items is to leave the adjusted pre-tax profit broadly unchanged. You'll find more details of adjusted performance, by region and by global business, in the data pack on our investor relations website.

This next slide summarises our quarterly profit performance over the last two years. What stands out here is that the good performance of the first three quarters was in marked contrast to the disappointing performance in the fourth quarter. This was marked by an increase from 4Q13 in operating expenses and a reduced revenue contribution from Global Banking and Markets, particularly in our markets business. These items more than offset revenue growth in Commercial Banking, notably in our home markets of the UK and Hong Kong.

The revenue reduction in Global Banking and Markets was in part due to the introduction of the funding fair value adjustment and certain derivative contracts of $263 million, and the fact that the fourth quarter of 2013 benefited from around $200 million of revaluation gains in Equities. Revenue also fell by $264 million in Credit. Overall, adjusted revenue was broadly flat, excluding the introduction of the funding fair value adjustment.

Overall, credit quality remains stable, although there were a number of individual impairments in Asia and Latin America in the quarter. These were not bound by any single unifying theme from an industry sector standpoint. We continued to invest in regulatory programmes in the fourth quarter, as we did throughout 2014. In addition, we had a higher bank levy following a rate increase by the UK Government. Other operating expenses increased by $439 million, reflecting the effects of inflation, higher marketing spend to support growth, as well as higher business support costs.

This next slide shows an analysis of profit before tax. As you can see, we grew adjusted profits in three out of our five regions, compared with 2013. Higher profits in Asia were driven primarily by mainland China, reflecting growth in Global Banking and Markets, higher average lending in Commercial Banking and wider deposit spreads in Retail Banking and Wealth Management. The Middle East and North Africa delivered a record reported profit before tax, driven by higher revenue in Egypt and the United Arab Emirates. Profit increased in North America, driven by lower loan impairment charges and operating expenses. This was partly offset by reduced revenue, due to continued runoff and loan sales from the CML portfolios.

Profits in Europe were down due to higher regulatory compliance and staff costs, in addition to the bank levy, which was $204 million higher than in 2013. This was partly offset by improved loan impairment charges. Revenue remained broadly flat. Profit in Latin America was impacted by increased operating expenses, mainly due to inflationary pressures in Brazil and Argentina. As we go through the following pages of the presentation, we'll talk through the global businesses in more detail.

This slide shows an analysis of revenue. Commercial Banking performed well, with an increase of $833 million. This was driven by credit and lending, and payments in cash management, notably in our home markets of Hong Kong and the UK. Principal Retail Banking and Wealth Management revenue was broadly unchanged, reflecting the effect of de-risking initiatives, a backdrop of continued low interest rates and muted growth in certain key markets. Higher income from current accounts, savings and deposits was broadly offset by lower revenues from personal lending and wealth management products.

Global Banking and Markets revenue, excluding legacy credit, was $278 million lower. This reflected a reduction in revenue in Markets, notably in our FX business, and the introduction of the funding fair value adjustment to non-collateralised derivative contracts. However, these reductions were partly offset by capital financing, where we increased both revenue and market share across our advisory, equity capital markets and lending products. Revenue was also marginally higher in payments and cash management and security services.

Global Private Banking attracted $14 billion of net new money in the parts of the business that fit our new model, mostly through clients of Global Banking and Markets and Commercial Banking. However, Global Private Banking revenue fell by 11%, as we continued to de-risk the business. Other revenue included the $647 million favourable fair value movement from management of our own long-term debt.

This next slide shows the growth in our customer lending and customer accounts over the past two years. This is a period in which we have been running off our CML portfolio and making disposals of non-strategic assets. You will notice that we've split our lending and customer accounts into red-inked and other balances. Red-inked balances relate to corporate overdraft and deposit positions where our clients benefit from net interest arrangements across the positions. We report these balances on a gross basis in our accounts.

During the fourth quarter, these red-ink balances decreased, as many clients settled both their overdraft and deposit positions. We've shown the red-inked balances separately to make clear that there has been consistent quarterly underlying balance sheet growth. On a constant currency basis and excluding the effect of red-ink balances, lending increased by $56 billion, or 7%, during 2014, notably in Asia and Europe. In Asia, lending growth includes Commercial Banking up 9%, principal Retail Banking and Wealth Management up 6% and Global Banking and Markets up 14%. In Europe, there was a lending growth in Commercial Banking.

In the current quarter, excluding effects of red-inked balances, loan growth was driven primarily by Global Banking and Markets, notably in Europe, Asia and North America, and in Commercial Banking, most notably in the UK.

On operating expenses, again on an adjusted basis, we saw an increase of $2.2 billion or 6%. We've also split out the adjusted cost by major category. As you will have noticed, we now refer to costs associated with regulatory change, regulatory programmes and compliance. To be clear, this includes the cost associated with new regulatory programmes such as stress testing, including CCAR, FATCA and Dodd-Frank, as well as costs associated with global standards and our compliance function. These costs increased by $774 million in 2014 to $2.4 billion, as we continue to build the necessary infrastructure to meet today's higher compliance standards, to prepare for multiple stress testing in a number of jurisdictions and to pave the way for structural reform.

Looking at the key drivers by global business, principal Retail Banking and Wealth Management was up by $1 billion. This reflected inflationary pressures, particularly in Latin America, higher costs associated with regulatory programmes and compliance, the UK Financial Services Compensation Scheme levy of $111 million and higher marketing costs across the regions.

Commercial Banking was up by $535 million, principally in Europe, Latin America and Asia. This was due to inflation and investment in staff to support revenue growth, notably in Asia. Spending on regulatory programmes and compliance also increased.

Global Banking and Markets increased by $569 million or 6%, primarily due to higher spending on regulatory programmes, compliance and increased staff costs. An increase of $443 million from other was caused by an increase in the bank levy of $204 million and higher spending on reg programmes and compliance. Against this, the continued runoff of the US portfolio reduced costs by $320 million, and Global Private Banking costs were down by $99 million.

In 2014, we delivered $1.3 billion of savings from streamlining and simplifying our businesses, processes and procedures, in line with our strategy. This and obviously more was re-invested, as I've previously described. In 2015, our teams will deliver more than $1 billion of savings, but our focus is shifting from generating sustainable savings, which are then re-invested in the business, to generating overall net savings. Our goal is to deliver a cost-line run rate, by the end of 2017, which is consistent with 2014. This means we will offset inflation of approximately $1 billion per year and fund investments in key growth initiatives and regulatory programme compliance through improved efficiency.

Adjusted loan impairment charges were down from $5.6 billion to $3.9 billion. The ratio of loan impairment charges to average gross loans and advances to customers fell to 39 basis points from 60 in the prior-year period. This was mainly due to lower loan impairment charges in Europe, North America and Latin America. The increase in the fourth quarter was caused by specific impairments in Asia and Latin America. Fourth-quarter impairments in Asia increased due to higher individual impairment charges in Global Banking and Markets in Hong Kong, and Commercial Banking in Hong Kong and mainland China. Latin America was affected by higher specific provisions in Commercial Banking in Brazil. It's worth noting again that there was no single unifying element that drove these impairments.

Looking at 2014 as a whole, Europe, $820 million better, driven primarily by Commercial Banking and Global Banking and Markets in the UK; North America was $862 million better, mainly in the CML runoff portfolios; Latin America was $292 million better, primarily in Mexico and, to a lesser extent, Brazil. In Mexico, the improvement in loan impairment charge primarily reflected the lower individually assessed charges in Commercial Banking, in particular relating to certain home builders. In Brazil, the improvement was driven by the non-recurrence of additional provisioning arising from changes made to the impairment model for structured loans in 2013, in addition to reduced collectively assessed impairments in Commercial Banking. This was partly offset by an increase in Global Banking and

Markets, due to an individually assessed impairment provision. Asia loan impairment charges increased largely as a consequence of the specific impairments already described.

This next slide shows the pro forma after-tax distribution of profits in 2014. We retained 32% and increased our distribution to shareholders to 53%. Dividends per ordinary share, in respect of the year, were 50 cents, an increase of 2% compared with 2013. 15% was allocated was to variable compensation. This is broadly in line with the communication provided on distribution at an earlier date. As you can see, we've increased the fourth interim dividend to 20 cents per ordinary share, in line with our progressive dividend policy. We currently plan to deliver the first three interim dividends of 10 cents per ordinary share in 2015.

Turning to capital, the Group's transitional Common Equity Tier 1 ratio was 10.9%, against 10.8% at the end of 2013. Our end-point Common Equity Tier 1 ratio was 11.1% on 31 December, compared with 10.1% at the end of 2013. This reflects continued capital generation of $5.1 billion, in addition to the $7.5 billion that we paid in total dividends during the year. Risk-weighted assets increased due to a combination of business growth in Commercial Banking and regulatory changes, including the introduction by the PRA of loss given default floors across a number of portfolios in the year. This was partially offset by a broad range of capital management initiatives and improvements in our capital management processing.

Based on the known and quantifiable requirements to date, the current end-point Common Equity Tier 1 required ratio is 10.6%. However, uncertainty remains around the amount of capital that banks will be required to hold, resulting from the inherently dynamic nature of some elements of the capital framework, such as the countercyclical capital buffer, sectoral capital requirements and the PRA's assessment of Pillar 2. There's also an ongoing review of risk-weighted assets across all risk types and the related application of capital floors. Given our capital position and the improving capital generative power of the Group, we believe we are well placed to meet the future capital requirements. With that, I'll hand back to Stuart.

Stuart Gulliver

This slide looks at the progression of ordinary shareholders' equity, return on equity and return on tangible equity. Our level of capital has increased by over 60% since the start of the financial crisis. Specifically since 2011, we've been required to progressively build our capital levels in response to increasing capital demands.

When we set our targets for the Group in 2011, we did so based on a capital ratio of 10%. Whilst this factored in foreseeable capital requirements, it did not anticipate and could not have anticipated the full extent of capital commitments and additional costs asked of us in the years to come. These factors include an increase in cost from regulatory demands and changes, and this has included costs associated with the new regulatory programmes, such as stress testing, FATCA and Dodd-Frank, as well as costs associated with global standards and our compliance function. In the last few years, we've made significant investment, including headcount, technology and processes, and upgrading our compliance capability, but we're still not at the top of that investment cycle. They also include the additional capital that we're required to hold by the PRA and other regulators, an increase in the UK bank levy, the continuing low-interest-rate environment and the impact of significant items, notably the high level of fines, settlements, UK customer redress and associated provisions. In 2014, these totalled $3.7 billion and, since 2011, these have totalled $11.3 billion.

To put it simply, the regulatory and operating environment in which we set our 12-15% return on equity target in 2011 no longer exists. That explains why, as the bottom chart shows, the Group's return on equity and equivalent return on tangible equity have reduced since the Group's capital level has increased. As a consequence, we are setting new targets that better reflect the present and ongoing operating environment. We are setting a revised return on equity target of greater than 10%. This target has been modelled using a Common Equity Tier 1 capital ratio on an end-point basis in the range of 12-13%. Our cost target will be to grow our revenues faster than our costs, on an adjusted basis, and we are restating our commitment to delivering a progressive dividend. To be clear, the progression of dividend should be consistent with the growth of the overall profitability of the Group, and is predicated on our ability to meet regulatory capital requirements in a timely manner. All of these targets will apply over the medium term. These targets offer a realistic reflection of the capabilities of HSBC in the prevailing operating environment.

To summarise, it's important to recognise the impact of a poor fourth quarter on what we view as otherwise reasonable results. Many of the challenging aspects of the fourth-quarter results were common to the industry as a whole. Our early 2015 performance has been satisfactory. These results show a business powered by our continued strength in Hong Kong, with significant additional contributions from the rest of Asia and the Middle East and North Africa. The continuing success of Commercial Banking and the resilience of our differentiated Global Banking and Markets business illustrate the effectiveness of our strategy to bridge global trade in capital flows.

The business remains in a good position structurally to capitalise on broader market trends, and the macroeconomic backdrop remains favourable, notwithstanding the continuing low-interest-rate environment. Our network covers some 85% of global trade in capital flows, and provides access to some of the fastest-growing geographies in the world. We are therefore extremely well positioned to grow our business, particularly in product areas that rely on international connectivity, such as payments and cash management, the internationalisation of the RMB and trade. We also continue to invest in geographies where the Group has a unique competitive advantage, such as in Greater China, particularly the Pearl River Delta and some of the biggest and fastest-growing global city clusters.

Despite this, there are still a number of historical issues left to resolve and we will make further progress on these in 2015. We'll also continue the work we started in 2011 to simplify the Group to make it easier to manage and control. We maintain a sharp focus on generating net savings to offset increased costs arising from inflation and the cost of implementing global standards. We continue to focus on the execution of our strategy and on delivering value to our shareholders. I'm now happy to take questions. The operator will explain the procedure and introduce the first question, operator.

Rohith Chandra-Rajan, Barclays

Good morning. Thanks very much for the updated targets. I was just wondering, just on the revised ROE target, if you could give us a bit more clarity in terms of moving from the current position to the greater than 10% in the medium term. The number you reported today is 7.3%. On an adjusted basis, it's maybe something slightly above 9%. If you adjust for the 12-13% CET1 that might knock 40-100 basis points off that, so we're looking at somewhere between 8% and 8.7% ROE moving to above 10%, so that's 15-25% increase in the ROE. I just wanted to check that's roughly the right maths and what the plan is to get there.

Secondly, just to clarify what Iain said on the cost target, if I understood correctly, Iain, your 2017 cost target is just to hold it flat at $37.9 billion, which is the 2014 number including all the one-offs in the year. Thanks.

Iain Mackay

To be clear on that last point, it's on an adjusted basis. I can't tell you what the one-offs are going to be in 2015, 2016 or 2017. We're focused on the cost base that we've got line of sight to and can control, so the ongoing operating expense base. That is on an adjusted basis that we're talking about. It would be really nice, by the way, if in 2017 we didn't have customer redress, fines, penalties and various other items, but I can't make that promise to you at this point.

Rohith Chandra-Rajan

Sorry, Iain, so that's $32.1 billion adjusted cost is what the target is for 2017.

Iain Mackay

No, the adjusted cost base is the $38 billion that you referred to. Your math, broadly speaking, Rohith, on the return on equity is pretty much on the mark, I would say. When you look at the underlying profit-generating capability of our four global businesses, and by that one of the measures internally is the return on risk-weighted assets, the generating capability in the round comes through to allow us to generate that 10% on return on equity. However, we have a number of businesses in the network today that are not operating at the level of profitability that they previously have done or that they are capable of doing, in our view, for some perfectly good reasons around repositioning and de-risking those businesses.

Those businesses are, and I think it's fairly obvious from the annual report and accounts, the United States, the Brazilian business, the Mexican business and, of some lesser significance in terms of scale, our Turkish business. Those four businesses are under intense scrutiny and get a great deal of management attention, in terms of driving the profitability of those businesses and performance. You'll also recall that, over the last couple of years, we've done very significant repositioning and de-risking of each of those businesses, and recognise that there's a rebuilding that has got to be undertaken. That continues. We continue within each of our businesses to look at capital allocations within that business, the efficiency of the return against those and, again, the ongoing work to ensure that the businesses perform efficiently.

From a cost perspective, and there's a good deal within this deck of slides around the costs, it's simply a fact that, for 2015, 2016 and 2017, we see in front of us headwinds as they relate to the implementation of regulations that only now are becoming real from an implementation perspective. Perhaps one of the most significant of those is structural change in the UK, for example. However, it's not the only thing. Stress testing as a tool that's regulated around the world is becoming significantly more intense than has ever been the case in the past. Therefore, investment within our systems and capabilities to deliver robust stress tests, in an efficient and effective manner, is clearly an area of focus for us at this point in time.

The focus from a cost perspective is to ensure that we generate the savings that allow us to continue to invest in the growth, compliance and regulatory capabilities of the firm and, by the time we reach the end of 2017, looking at a run rate for 2018 which takes us back to that level that we talked about in 2014. There is, it's fair to say, a long list of items that the management team works on internally, some of which, but not exclusively, are focused on generating an improvement of the performance of the four businesses that I mentioned.

Rohith Chandra-Rajan

Thank you. As well as all of that work that you've just flagged, to get to a 10% ROE, do you need a different rate environment from the one we're currently in?

Stuart Gulliver

We've assumed the same expectation of interest rate rises in the UK and the US that the futures market implies and no change in rates in the eurozone so, no, we don't need a substantial change in the interest rate environment. It would be rather helpful, but this is based on where the futures market has US and UK rate rises. Thanks very much. Can we take the next one please?

Tom Rayner, Exane BNP Paribas

Good morning, chaps. I had two questions, but can I before just go back to the costs thing, please? It sounds like you've set a very aggressive cost number, it seems to me, out there to keep it flat in underlying terms, given the underlying wage inflation. You're offsetting investment with some cost saving. It just sounds like a surprisingly strong number you've put out there for 2018, rather than 2017. I didn't notice much in the actual release today talking about that. Is this something new, like a kind of a new cost programme over and above what you've been talking to us about for the last year or two, or is this just part of the same sort of procedure, but maybe some of the compliance stuff is just dropping away now? Can you maybe help me understand how we're going to be looking at $38 billion in 2018, given that's where the costs were in 2014, and we do have underlying inflation in wages, property and all the rest of it? Then I had a couple of questions more on the capital side, if that's okay.

Iain Mackay

Sure, Tom. Over the last four years, we've generated the better part of $6 billion in sustainable saves. Although that's not been entirely linear, that's the better part of $1.5 billion a year that we've generated from either stopping doing things, namely selling, closing businesses, restructuring the way the firm's managed, improving processes, implementing new technology – a very, very, very broad range of products. It runs to hundreds, dare I say thousands, of projects to deliver those $6 billion of sustainable saves, which have been reinvested in the business, around implementing global standards, broader compliance capabilities, investment in new product and distribution, whether it's FX, PCM, Pearl River Delta investment from a distribution perspective, digital capability from a Retail Banking and Wealth Management and other businesses perspective. What we're talking about is a continuation of generating those cost savings that we've been able to generate over the past four years.

I think what we would all have hoped for is that, by the time we reached 2015, we had a greater deal of clarity about what the regulatory and performance expectations of the Group are going forward. The simple fact of the matter is there's more regulation coming. Although we know the general shape of much of it, there's still a great deal that's being consulted and developed, whether it's a fundamental review of the trading book, whether it's a re-visitation of the standard measurement for risk-weighted assets. There's obviously the ongoing phase-in of CRD IV to be completed over the next few years, although we have a greater clarity about what that means.

The structural reshaping of the UK business, frankly, is only just getting underway. We submitted our plans back in November. We think those are good plans, but the actual work of restructuring the UK business – separating out a ringfence, setting up a servco to support both ringfence and non-ringfence banking activities – is only now getting underway, and there are significant costs implied with each of those.

The reason we take 2017-18 as the target point is that we clearly see, for the next two to three years, a very significant effort to generate savings to be able to fund the investment that we need to undertake to accomplish some of the outcomes that we're talking about there. It's aggressive, but it's aggressive informed by what we've been able to accomplish over the last four years to a significant degree.

Tom Rayner

In terms of additional restructuring charges in order to help you get there, is that something we should be thinking about?

Iain Mackay

I think it's a reasonable expectation, Tom. We don't know what those are right now, because exactly the nature of what we're going to be required to do is not entirely clear, but it's why we're not committing today, in 2015, to the cost base of 2014. We know we have to invest to accomplish some of these outcomes, but we will also continue to invest in our ability to run the firm more efficiently. It is therefore possible that there will be restructuring charges and, you can be rest assured, as and when they arrive, or when we put clear line of sight to what they will be, we'll communicate them.

Stuart Gulliver

As Iain's saying, don't assume this is linear. We're clearly going to have to spend some money to actually restructure and get those costs down there, so don't assume 2015 is the same as 2018.

Tom Rayner

Thanks a lot on that. Just on the capital, on TLAC, do you think there's much hope of getting some of the proposals watered down? I know that the consultation has been ongoing. I've seen your submission to it. I just wondered if you had much confidence that, actually, there will be some watering-down. Just a final one – it kind of links into TLAC – is there a case, if there is no watering-down of all of these global regulations, which kind of penalise bigger banks and more global banks, like yourselves, for actually then addressing your own structure? The cost of the regulation is just becoming so high relative to banks that are maybe smaller or less global in scale. Those two things are wrapped together really.

Iain Mackay

On TLAC, Tom, it's still early days. You've seen our response that was sent in on 2 February, so you've got the information on that. What will ensue over 2015 is a quantitative impact study. Our engagement in that, I'm sure, will be as thoughtful as the engagement of many of our peers in the GSIB category. You know, the proposals that are out there have fairly wide-ranging implications, some of them which may, in actual fact, create perverse incentives for the industry as it relates to a diversified and stable source of funding, which is something that HSBC is known for as a strength for many, many years. We certainly would like to ensure that we maintain that diversified and stable funding approach. As to the likelihood of being able to come up with any changes to the proposals that were put out at the end of last year, I still think it's a little bit too early in the process.

Stuart Gulliver

I think as well, Tom, that the break up the bank argument – we'd need to look at where this QIS takes things, because actually, we believe it would destroy shareholder value; that we're not really trading at a conglomerate discount. Because we estimate that 40% to 50% of our revenues are linked to our international network; i.e. 40% to 50% of the revenues in both Commercial Banking and Global Banking and Markets come from the ability to finance capital flows and trade flows across that network. And so, the break-up argument doesn't work as well for us as it does for some other institutions.

Iain Mackay

Okay, and back to some of the specifics that were in the original of TLAC. It covered risk-weighted assets that are invested in our associates. It seems very odd to us that we could be required to pre-position loss-absorbing capacity for BoCom or Saudi Arabia British Bank, for example. So when you start addressing some of those technical aspects within the proposal, you start skinnying back the overall loss-absorbing capacity requirement that the Group may have. So, early days. You've seen what our consultation feedback was. It's clearly something about which we feel, actually, the structure of the Group lends itself to the very stability that the regulation hopes to achieve, and we'll certainly continue to work as closely as we can with the FSB and other regulators to achieve the desired outcomes.

Stuart Gulliver

But absolutely no complacency here on the need to improve some of the performance of some of the businesses, and we'll do whatever's required as and when everything settles down.

Tom Rayner

Okay. Thanks very much for that.

Stuart Gulliver

Thanks, Tom. Next, please?

Alastair Ryan, Bank of America

Thank you. Good morning. Two, if I may. First, on the net interest margin, I mean, shaved off sort of a basis point or two in the second half. Just whether the more difficult rate curve picture globally put some more pressure on that. Stability was, I think, the word you were using three or six months ago; whether that still applies, there's levers you can pull to, you know, offset pressures on balance sheet management and suchlike. And then, secondly, on costs again, just trying to – I'm sure you've been anticipating – well, not an obsession, but underlying costs went up a couple of billion dollars last year. Looks like it went up about a billon and a half the year before, on a slightly different underlying versus adjusted basis, but there's been ongoing growth, which would be consistent with you pulling volume back through the business. It's the 7% growth you talked about, Iain. You know – I'm just struggling to get to how you can deliver flat nominal numbers while growing the bank at that pace. So what I'm trying to get to, I guess, is it difficult for you to keep 7% up? Is there effectively a slow-down in the pace of business expansion which is included in your flat nominal cost guidance? Thank you.

Iain Mackay

So on NIMs first, Alastair, you're right. NIMs, in the round, came off a couple of basis points, and overall for the year for the Group, they were off a little bit more than 10 basis points. Some of the factors that build into that, you're well-versed on. There's some influence from the continued run-off of the US CML portfolios. We certainly saw the cost of funding in Latin America step up, and as we've reshaped that Latin American business, moving from unsecured personal and unsecured lending into more secured, we've seen some pressure on our margins in the Latin American business. When you look at the businesses in Europe and Asia, in the round, the margins have been fairly stable. Certainly, as it relates to trade, as it relates to the broader credit and lending businesses, we've been able to either hold it steady or in actual fact expand in one or two of the markets. But in the round, we don't see anything that has a particularly adverse downward pressure on net interest margins, but, in truth, nor do we see a particularly upward facilitation, either.

One of the things that does sit within net interest income, which does have an influence on net interest margin, was the redress related to the Consumer Credit Act in the United Kingdom. So that's a net interest income item, and $632 million came off our net interest income line in the course of the year, and that clearly has an effect on the overall net interest margin; an effect to the tune of about four basis points. So with an overall decline of about 10 or 11 basis points for the group, a little bit more than four basis points came out of the Consumer Credit Act, and another five basis points came out of the repos and reverse repos that do not sit in the trading book. Obviously, very low margin. But in the round, we see margins as broadly stable, excluding what I've described in Latin America, and the continued run-off of CML in the US.

In terms of volumes, there's absolutely within our expectation the continuation to grow the businesses. Clearly, the rate at which those businesses can grow is very different by economy, and when you look at the adjusted growth that we generated in the top line in Asia this year, for example, it was slightly over 8%. Don't take that as a proxy for what we would grow in each and every year, but when we think about managing the cost base, what we've set ourselves is by the time we exit 2017, we're able to realise a cost base which is largely in line with that which we've put in 2014 from an adjusted perspective. And as we said earlier, there's investment required – whether it's in restructuring the Bank, whether it's – and by that, I mean restructuring to meet regulatory requirements in the UK – as well as continued investment in global standards and compliance capability across the Group.

One of the key drivers of that increased cost base over the last two to three years has been the investment in regulatory programmes and compliance. We now have in excess of 2.4 billion in our cost base which is tied up within those regulatory programmes and compliance. More than three-quarters of a billion of that was built within 2014. So though it's fair to say, when you look at what's included in that category – structural change, continuing to build our capability around stress-testing, full deployment of Dodd-Frank Act, meeting the requirements of common reporting standards, to name a few – we expect those costs to continue to increase, certainly though 2015, 2016, and possibly 2017. But it is exactly those costs which focus our attention around generating savings through re-engineering business, customer-facing processes, as well as the back office to become more efficient, as we have done over the last four years.

Alastair Ryan

Thank you.

Stuart Gulliver

Thanks very much. Next one, please.

John-Paul Crutchley, UBS

Morning, chaps. JP here from UBS. I wanted to come back to the question on capital and the structural question that Tom alluded to. I mean, obviously not going as far as debating that sort of splitting up the bank or anything which, obviously, would be very destructive for shareholder value, but I guess – clearly, when you're talking about going to a higher range for capital for 12, to 13, and I guess you're thinking about potentially being at the top end of that range, against where your risk assets are at the moment. That implies something like $160 billion of Common Equity Tier 1 versus the $136, so about $24 billion more. And I guess – well, what I ask myself is, 'Why is that the right answer?' as opposed to needing more capital to support this business, rather than actually turning it around the other way and thinking, 'Well, I have a certain amount of capital which can support a certain amount of risk assets'. The business clearly isn't generating a high enough return, as we were talking about earlier with Rohith. So the answer is actually to re-base the business on the capital we've got, to try and improve returns.

And I guess within that, I end up thinking about the GBM business, which when I look at it, it looks like a sort of 25 to 30 basis point RoRWA-type business, which can obviously be levered around 20-ish times, which seems to me to imply a business that's structurally incapable of delivering much more than a mid-single-digit ROE business and clearly consumes a large amount of Group capital. So when we look around the world, clearly, we see a whole raft of wholesale businesses wrestling with existential questions about returns and, you know, how they configure themselves for the new world, etc. And I don't seem to get that sense here. So, I guess, why is the answer not actually, 'GBM, you've got to run with a lower amount of risk assets because the world which we live in, they're a lot more expensive, and your business model isn't delivering the return on risk of the other parts of the group', rather than just saying, 'Okay, well, our number now's somewhere between 12 and 13, therefore, we need more equity capital to support the business we've basically got at the moment, and we'll try and square the returns some other way'? So maybe you can just help me understand why you don't feel the pressure for existential change or business model change within GBM that is clearly a pressure in most other banks of your size and shape?

Stuart Gulliver

So, JP, the honest answer is we'll be doing both. I mean, we sold 77 businesses in the four and a bit years this team has been in place, so you can rest assured that we're looking at things from both ends of this spectrum. And actually, the following businesses – what you've just analysed can be applied to all of these. So the USA, Brazil, Mexico, Turkey, parts of Global Banking and Markets, and actually CMB and the rest of Asia-Pacific. So we'll effectively be tackling it from both ends. Yes, we can build the amount of capital up, and that won't be set by us: the 12 to 13 will be set by a regulator, by the PRA. It won't actually be set by ourselves, and in any event, in parallel to that, we will be looking at the returns of all of those businesses, because they're the ones that are dragging our ROE down.

Iain Mackay

I guess other factors to consider within that, JP – we are still sitting on a legacy book of SICs and SIVs in GB&M, which we continue to run off. We ran off about $19 billion of those assets in 2014. But it goes exactly to Stuart's point. We're going through the portfolio. I mean, we talked a great deal back in 2011 about doing this five and six filters review. That review process has never really stopped. So when we look at businesses that are returning at levels below that which will generate returns against a regulatory capital requirement, the business is getting the scrutiny and attention that it needs. And if that leads us ultimately to the point that you can't run the business more efficiently, it's entirely reasonable to assume that this management team will exit some of those businesses.

John-Paul Crutchley

That's helpful. Thank you very much.

Stuart Gulliver

That's useful. Next question, please.

Manus Costello, Autonomous Research

Morning. I just wanted to follow up, actually, on a couple of questions. Following up on JP's point there about the GBM capital allocation, the way you answered the question there suggested you'd go kind of bottom-up, business by businesses, but I wondered if you'd ever think about the overall shape of the group, and GBM consumes 42% of risk assets at the moment. Would you ever take a decision to say, actually, that's too much; we want it smaller, or would you always look bottom-up and deliver it by different business unit, in terms of the return on risk-weighted asset that they're delivering?

Stuart Gulliver

I think we would probably do it bottom-up. Don't forget, also, Global Banking and Markets has got in it Balance Sheet Management, so it's got a chunk of the surplus capital, the surplus deposits of the Group, sitting within it. It would be done bottom-up, because also, at design level at the top of the firm, I kind of want this to be third-third-third, coming from Global Banking and Markets, Commercial Banking, Retail Bank, Wealth Management. We believe in the universal banking model. We believe we should be diversified by customer group and by geography. So what I wouldn't want to do is to do it in the other direction, and either skew to too large a dominance of any one of those three businesses. That's what gives us some stability through the cycle. At various points, just in the four and a bit years we've all been doing this, either RBWM's been the key business, or Commercial Banking's been the key business, or Global Banking and Markets has.

And also, there's a substantial amount of collaboration revenues that we get by having these three businesses. Private Banking, which is obviously the small piece, now sourced last year 14 billion of new AUM from existing Commercial Banking and Global Banking and Markets clients – so the C-suite of Global Banking clients, and the entrepreneurs that tend to sit at the heart of Commercial Banking clients. There are also a huge number of transactions, some of which are now in the public domain, where you can see Global Banking and Markets teams working with Commercial Banking clients, either to do high-yield bonds or to do M&A transactions. All of that would go away if you do a top-down, 'I don't want to be in Global Banking and Markets', type of approach. So it's got to be done at a very detailed level. Otherwise, I think, you threaten the universal banking model, and you lose the collaboration revenues.

Manus Costello

And 'a third, a third, a third' is – you were talking about it as profits excluding Balance Sheet Management revenue profits, broadly?

Stuart Gulliver

It's all in.

Manus Costello

All in? Okay. Thank you. My second question was on costs, just to come back to this nominal cost target, which – I agree with Tom; I didn't see it in the release anywhere, and it seems quite a material change, certainly versus the trajectory that consensus is on. I wanted you to place that in the context – it sounds like the costs will basically go up before they come down, from the comments you were making previously, Iain, but you've got your positive jaws target, so I wondered if you could tell us whether that positive jaws target is about through the period, or whether you'd hope to achieve that each year between now and '18.

Iain Mackay

You know, the positive jaws target has been fairly consistent, actually, since 2011. Unfortunately, we've not been able to accomplish in every year, clearly, but the focus for our businesses is to grow the revenue base ahead of the rate at which they grow their costs. And the challenge going back to each of the global businesses and each of the global functions, to fundamentally look at the cost base and reflect on that cost base in the context of a revenue-generating capability.

So if a business sits and looks at its revenue generation and says, 'Right, hang on a second, chaps. We're not going to generate at the level at which we'd planned', then get on top of your costs and don't assume that you can expend the kind of money that was included in your plan, either. And that's a discipline which we're going to continue to enforce, and presumably drive our global businesses and functions a little bit potty around being able to make that discernment between a cost plan and a revenue generation capability on an actual basis throughout each year. But taking away that there is a need to invest, to accomplish that cost exit rate, is absolutely an appropriate conclusion to draw. This is not a straight line equation.

Manus Costello

Sorry, just to be clear: on an adjusted basis, do you think jaws will be positive in 2015?

Iain Mackay

That's certainly what we're planning for.

Manus Costello

Thank you.

Stuart Gulliver

Next one, please.

Chintan Joshi, Nomura

Hi, good morning. Can I ask one on capital, and then just follow up again on the salary discussion you've been having? On capital, I mean, sterilisation of scrip was one of the targets you had. I wonder how you think about it now. You know, it seems like it'll be at least a few years before we can talk about that, especially if we're talking about growing the business, rather than shrinking the business to the current capital base.

Stuart Gulliver

I think you're right. I don't think we will be sterilising the scrips in the medium term.

Chintan Joshi

Understood. The other point to follow up was on the cost/income ratio. Is the high 50s cost/income ratio you were talking in Q3 still relevant, or is it just positive jaws now?

Stuart Gulliver

Just positive jaws.

Chintan Joshi

Okay. And finally, you have formally kind of accepted the 12%-13% CET1 ratio range. I suspect you already have a pretty comprehensive, going back to the drawing board, kind of exercise that you're doing in the background. Do you think we'll get more clarity on which direction you are going – i.e. how much you're going to cut, where you will be growing – at some point in the near term? You know, three, six months down the line? Just to get a better sense of business plan. There are a lot of unknowns – if I listen to all the conversations we've had in the last half an hour – that we need a bit of filling in on.

Iain Mackay

Certainly, in terms of where the capital requirements are going, the clarity continues to emerge little by little. Again, if you get around to at some point in the next six months, Chintan, looking at the Pillar 3 document and the capital section in the annual report and accounts, we write a great deal about where capital regulation is moving; what the possible complication of that is; over what period of time it is to be phased in; how the PRA is reflecting on a PRA buffer, for example, through its consultation on Pillar 2. All of those things, I think, will continue to provide some clarity over 2013. There's consultation out there at the moment on fundamental review of the trading book, revised approach to standardized measures – none of which probably bite in 2015; possibly not even in '16, but beyond that point – and again, we'll be very much engaged in the debate and the consultation and QIS's that will support that.

To the extent clarity then emerges, or looks as if it's going to emerge, then that will inform the actions that we as a management team take around the shape of the business to generate the returns that we're talking about, given those capital requirements. And again, that may inform us that you simply can't improve the efficiency of the business based on new capital and regulatory requirements, in which case, we would contemplate exiting them. Or it may simply be an aspect of changing the way in which we conduct that business, such that we can generate the commensurate returns. But that clarity will emerge as clarity emerges around the capital and regulatory structure. It's improved in 2015 on the implementation of CRD IV, but there's still a lot of stuff out there, and we mentioned – well, actually, a pretty exhaustive disclosure on it in the annual report and accounts in Pillar 3. But you know what they are just as well as I do, but we will respond to either in line with what becomes clear, or when we've got a reasonable expectation of what may become clear, we'll try and anticipate it.

Stuart Gulliver

But you can rest assured that there are no sacred cows. So as the capital environment develops, we'll take a very objective, hard look at all of our businesses, as we have done.

Chintan Joshi

Indeed. If we assume that some of these things will be hawkish, we're already in a 12%-13% range. And I take your point on RWAs, we don't know where we are on a number of consultations, but direction of travel seems to be higher. So some of the hard decisions already can be taken. I guess you're already taking it. Some visibility around that would be helpful down the line, is all I'm trying to say. I'll leave it at that.

Stuart Gulliver

I mean, we understand what you're saying, but there's obviously a balance on both sides as we move to restructure stuff.

Chintan Joshi

Understood. Thank you.

Stuart Gulliver

Thank you very much. Thanks, Chintan. Next, please.

Stephen Andrews, UBS

Hi, Stuart. Stephen Andrews from UBS. Just coming back again to returns and capital, if I look at the Hongkong and Shanghai Banking Corp in Asia, which is about 40% of your Group's capital, that's still cracking on, making a 16%, 17% return on equity in a zero interest rate world. So you're selling a 10% ROE target for the group, so by definition, obviously, two-thirds of your capital's making probably –

Stuart Gulliver

A very small return, yeah.

Stephen Andrews

A small return. I just wanted to clarify what I'm hearing today. Am I right in thinking that you're much more willing and open to selling, say, Mexico and Brazil than you were before? Because obviously that's one way of freeing up capital and helping to re-base your Tier 1 relatively quickly. Am I reading too much into that?

Stuart Gulliver

So I wouldn't want to talk about particular countries in terms of disposals, for very obvious reasons, but what I would say to you is that there – and Iain's mentioned this already – we're involved at the moment in fortnightly calls, 'we' being Iain and myself and the global business heads, on Brazil, Mexico, United States, and Turkey, which are clearly the four which present the biggest problems in this regard. So we absolutely need to turn them round, or we would need to think of more extreme solutions to the problem. And as I mentioned earlier, there are bits of Global Banking and Markets that needs to sharpen its pencil, but overall, I think it's an important business, and doing well. And there are bits of Commercial Banking that needs to sharpen its pencil, as well. So at this stage, what I would acknowledge is, yeah, there are parts of the group that aren't offering a return that's anywhere near their cost of equity, and we're working on restructuring those. And there are no options in terms of that restructuring that we would not consider.

Stephen Andrews

Okay, and just one final follow-up on that: what sort of timeline are you thinking of, in terms of how long these businesses have to prove their worth? You know, are we talking 12 months, or are we still talking two or three years?

Stuart Gulliver

No, I think we're talking 12 to 24 months.

Stephen Andrews

Okay, that's very clear. Thank you.

Stuart Gulliver

Thank you. Next, please.

Martin Leitgeb, Goldman Sachs

Yes, hello. Just a follow-up question with regards to this debate on capital a bit earlier, and you mentioned that the review of trading book with regard to risk weighting. I was wondering if you could just update us if there was any particular areas where you see upward pressure on risk weights, either this year or next year; whether that's in the UK mortgage space, or anywhere else.

Iain Mackay

In terms of 2015 specifically, no. Obviously, in 2014, we had the implementation of CRD IV, which provided some regulatory upward pressure in certain areas, particularly in Global Banking and Markets; particularly as it related to securitisation vehicles. When you think about other areas that may be influenced in '15, CVA is one area that's under review. When you sort of go beyond that, I think you start thinking about '16 and, probably more pointedly, '17 impact, as the result of consultation around fundamental review of the trading book and revisiting the standardized approach comes in.

The other area that may kick in is if any of our local regulators decide to implement particular risk-weighted asset floors on particular types of business within their markets. You've seen that, obviously, over the course of the last 18 months or so, with Hong Kong putting in a risk-weighted asset minimum requirement on mortgages. The PRA has required us to implement loss-given default floors across a number of corporate banking portfolios around the world, as well. So that's more of a localised, if you like, local market idiosyncrasies that may come from local regulators, but in the round, I think CVA's one possible area for 2015. But we're talking more about longer-term, in terms of '16, '17, as we look at some of those fundamental reviews being undertaken by the Basel committee.

Martin Leitgeb

Thanks, and then I just have one more question, which is a bit broader in context. And just looking at the context of today's regulatory environment, how are you thinking about the cost of complexity versus the benefit of scale for your business?

Stuart Gulliver

So it's hard to sort of express this in a mathematical way, but obviously, part of our scale informs our ability to finance capital flows, which derives or defines our profitability in foreign exchange; debt capital markets, payments cash and management, securities custodian. And our scale and the ability to sit across trade corridors defines our ability to make profits in trade. All of the things I've just outlined turn up in both Commercial Banking and Global Banking and Markets. So I think that what I would honestly say is that probably you can be large and do relatively simple things, but you probably can't be as large and do complex things.

So we continue to work on simplifying the firm. We've sold 77 businesses; we may sell some more. But there is not, if you like, a mathematical calculation that we're up to. And I think that the cost of complexity – it clearly sits within the GSIB. It clearly sits within that additional buffer, because part of it is your connectiveness, etc. And, yes, we're constantly thinking this through, but as I say, it's – well, I guess what I'm saying is the ultimate simple comparison is to say, have a look at Santander's business model, which is a very big retail bank in four or five countries, and compare it to ours. I think that's a complete miscomparison. We make our money in Commercial Banking, Global Banking and Markets, and yes, we make a chunk in Retail Banking, but if you look at the first two, that 60%, 70% of the Group's profit comes from sitting across trade corridors; it comes from banking city clusters; it comes from capital flows. So therefore, by definition, we're going to have – if you're looking at geography, to power that network.

Iain Mackay

Yeah, we also need to put the current performance, as well, in the context of dealing with some of our legacy and historical issues. You know, you take this P&L and you look at it on an adjusted basis, and you take out the fines, the penalties – the stuff that, frankly, we've been dealing with for a number of years now – and virtually every single one of them goes back to pre-2010 and before. And I'm not sure we would necessarily be having exactly the same conversation if we were looking purely at an adjusted basis, as opposed to the weight that these issues place on any given quarter's earnings, and there was clearly very, very significant pressure on the quarterly earnings. So the work that we started in 2011 around reshaping the Group, whether in response to the scale, the complexity, the profitability, the attractiveness of the markets in which we operate – that work continues, and it will continue.

Clearly, what we've got to do is continue to provide as much clarity as we possibly can to the marketplace about what the cost of addressing historical issues may be for this group, and to the extent we at all can, we disclose that both in this presentation and also in Note 40 to the financial statements, in that regard. And we'll continue to keep that information coming to the market as and when we've got greater clarity around the impact of those issues, but the work that we do in terms of reshaping the Group is much more focused at the fundamentals, as well as dealing with some of the legacy issues that we clearly have to deal with on a day to day basis.

Stuart Gulliver

And again, to reiterate that point – you know, if complexity equals fines and so on from legacy issues, clearly the firm is structured differently today than it was in those periods of time. And we have substantially changed the way the firm is run since the beginning of 2011 to avoid those types of issues resurfacing in the future.

Martin Leitgeb

Thank you very much.

Stuart Gulliver

Thanks, Martin. We've got time for three more, so next one, please.

Sandy Chen, Cenkos Securities

Morning. Just two questions, one on – you mentioned the ServCo being set up. Could you just elaborate a bit more in terms of how that might be capitalised, and how this might affect the capital ratio calculations, both in terms of an individual country basis and especially vis-à-vis UK ring-fencing? The other question is, sort of getting back to capital again, you have given the guidance of a CET1 ratio target of 12-13%. I would imagine that that's based on the risk weights as are currently calculated. I mean, if the BCBS consultation papers come back with higher risk weights or risk weight floors and all that kind of stuff, would you shift that CET1 target downwards or would you hold onto that 12-13% quota?

Stuart Gulliver

So let me start on the 12 to 13. The 12 to 13 is not a target. This is where I think we got ourselves into a bit of a pickle in 2011, when we said that we would have it as a target, because of course it's set by regulators; it's not set by us anyway. So the 12 to 13 is what we assume regulators might set for us, and, if they change that, then obviously we'd have to revisit things, and revisit things not necessarily in terms of changing the ROE target but perhaps restructuring more businesses or disposing of more businesses.

Sandy Chen

Yes, understood.

Stuart Gulliver

So, absolutely, that's what we would expect. We would respond is the best way to think about it, Sandy.

Sandy Chen

Okay, thank you.

Iain Mackay

When you think about the influence of RWAs in this, they influence obviously the amount of capital we need to carry and therefore the returns on that. If those businesses generating those risk-weighted assets cannot realise the kinds of returns we would target, then you go back to the points that we earlier made: we'll revisit this from the bottom up and restructure, dispose of those businesses that can't do it. So the RWA aspect of this is clearly an important input, but only to the extent that it informs one part of the equation around returns.

From the ServCo perspective, the focus, certainly from an HSBC perspective, certainly as we consider ourselves a multiple-point-of-entry resolution entity, is not just a UK construct but a global construct, and a construct which in many regards exists to a significant degree within the Group today. But, in specifically the context of the UK ring-fenced banking legislation, the intention would be to put, if you like, the support process, the operations, the core operations that support a ring-fenced bank and a non-ring-fenced bank in a bankruptcy-remote ServCo, and that ServCo would be required to be prefunded and to have a level of capitalisation. The level of capitalisation, certainly as far as we can reasonably expect now, would be consistent with the overall level of capital that the Group would be required to hold, so we don't think necessarily it changes fundamentally the structure of capital, merely the location of that capital from a legal-entity standpoint.

So the goal for ServCo is to have a globally consistent operating structure that supports our banking entities with consistent processes in a bankruptcy-remote vehicle which would support those entities around the world, and that that would be prefunded and capitalised at a level consistent with the overall operations of the Group.

Sandy Chen

Thank you.

Stuart Gulliver

Thanks very much. Next, please.

Chris Manners, Morgan Stanley

Good morning, everyone. Just two questions, if I may. The first one was just maybe a little bit more on your 12-13% common equity tier-1 ratio, just maybe how much of a management buffer would be in that? What are you expecting for a through-the-cycle countercyclical buffer? I saw the Pillar 2A crept up, just trying to understand the sort of breakdown of that target. And the second one was just on cost of risk – obviously, 50 BPS in the quarter; you're still seeing write-backs in the US. I think that most people are looking for a normalised cost of risk for you in 2017 of something like a 40 BPS. Is that about the right sort of number to pencil in to get to your targets, or just how you think about that normalised cost of risk number? Thank you.

Iain Mackay

So, to reiterate, 12-13% common equity tier-1 is not a target. This is what we anticipate; this is not what regulators have told us our capital requirement is. In actual fact, we've disclosed in the annual report and accounts what – in fact, in the chart today we've set out what the capital requirement is on an endpoint basis: it's 10.6%. We're presently sitting at 11.1% on an endpoint basis. What we do have an expectation is is that that capital requirement we anticipate will grow over the coming years. To what extent it will grow, where it will grow and by what drivers it might grow I simply cannot tell you, and therefore I can't really tell you what management buffers may be quantified at, other than the fact that we will always maintain some management buffer over and above the minimum capital requirements that, if we were to dip below those requirements, it would have an automatic impact on our ability to control our own destiny with respect to distributions. So, as and when, Chris, there becomes greater clarity for the industry as a whole, we'll provide that clarity to you, but I can't do that today because it's not there.

As for cost of risk overall, I can't plug your spreadsheet for you. Look, we went from 60 BPS in 2013 to 39 BPS in 2014. We, I think, have a very, very diligent oversight of credit risk that we see by legal entity, by business, around the Group. If I were to tell you how we model precisely, I'd be telling you components of my financial plan, and I'm not going to do that. What I can tell you is that we've got very stable credit quality in all of the environments in which we're operating. Although we saw a little bit of a tick-up in China and Hong Kong in the fourth quarter, it was for very specific, individually assessed credits, some of which you will have seen in the news, so it is not indicative of an underlying deterioration in credit quality.

Chris Manners

Thanks very much.

Stuart Gulliver

Thank you. Next one, please – last one.

Arturo De Frias, Santander

Hi, good morning, everybody. Just two quick ones, one, again, on the 12-13% core equity tier-1. When you talk about your ROE target, you say in the medium term, but I guess, when you think about this 12-13% capital ratio, it's going to be earlier, probably; you need to get there earlier than, let's say, medium term, because, if I think about TLAC, I think about PRA, if I think about Pillar 2, etc., are you probably thinking about 2017 as the year in which you will have to have this 12-13% core equity tier-1 ratio? And the second one would be on your collaboration revenues. You have mentioned several times in past years collaboration revenues as a key reason for your business model. Could you quantify what is the current level of your collaboration revenues between GBM and the other two big units? Thank you.

Iain Mackay

So, to be clear, TLAC is not a common equity tier-1 measure.

Arturo De Frias

Sure, I know that, but it's part of the story.

Iain Mackay

It's part of the story, but it's not part of the common equity tier-1 story. So, in terms of when we need to get there, today, our endpoint 2019 common equity tier-1 requirement, as communicated to us by the PRA, is 10.6%, right? Our expectation is that there is a framework in CRD IV which would allow the implementation of, for example, countercyclical buffers, sectoral capital requirements, PRA buffers, which are out for consultation at the moment, which may – and our anticipation is that, over the medium term, there would be an increase in the possible capital requirements of us. But in terms of having to get to 12% or 13% in the context of 2015 is simply not part of the equation. What is important to note, and has been the case in 2013/14 and years before – the Group has a very strong capital generative capability. Net of dividends paid to shareholders, we generated more than $5 billion worth of capital, which has been retained within the Group to support business operations and meet reg requirements, and that's in a year which certainly three quarters of performance was reasonably encouraging, but a very, very difficult fourth quarter.

So we will build capital to the level that meets regulatory requirements and provides some management buffer over those requirements to the extent we believe it's necessary in terms of retaining, within our own hands, our destiny as it relates to the distribution of the profits of the Group, but there's not enough information about TLAC to say what the total loss-absorbing capacity of the Group might be, and there's certainly not enough clarity right now to say whether or not, in actual fact, 12-13% will ever be required, although I suspect the vast majority of people on this telephone call believe it will be.

Arturo De Frias

That was exactly what I was asking, because, if we think 2017, from your current endpoint, 11.1%, you would need – and assuming flat RWAs, which might not be the case – you would need to generate internally around $24 billion of equity to get to 13%.

Iain Mackay

Yep, mathematics are okay, yep. Yep, not something that particularly concerns me, when I look at the capital generating capability of the Group.

Arturo De Frias

Okay.

Iain Mackay

As far as your collaboration question goes, Arturo, there was over $4 billion of collaboration revenues, and that was principally between Commercial Banking and Global Banking and Markets, but not exclusively. That also includes lesser amounts with the Private Bank and with Retail Banking and Wealth Management.

Arturo De Frias

Okay. Excellent, thank you very much.

Stuart Gulliver

Thank you. Thanks, Arturo. Thanks very much. This brings the call to an end. Thank you. Thanks, everyone.