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CAFRAL Conference of CEOs

Managing capital in a dynamic risk environment

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HSBC 

- **Environment and trends**
- HSBC Group priorities and strategic actions
- Capital, Risk and Performance management

Macroeconomic context

- Fiscal deficits in mature economies
 - e.g.: USA budget balance **-8.6%** in 2011, debt is c. 95% of GDP

- Inflation risk in emerging markets
 - e.g.: 2011 inflation forecast China 4.8%, India 8.0%, Vietnam 16.7%

- Currency changes
 - Exchange rate volatility
e.g.: AUD/USD 13% appreciation in one and a half months (March 16: 0.9726, May 1: 1.0973)
 - Longer-term rise of the RMB

- Geo-political risks
 - E.g., “Arab Spring”

Key trends

- A** **Connectivity** will continue to drive Global Economy

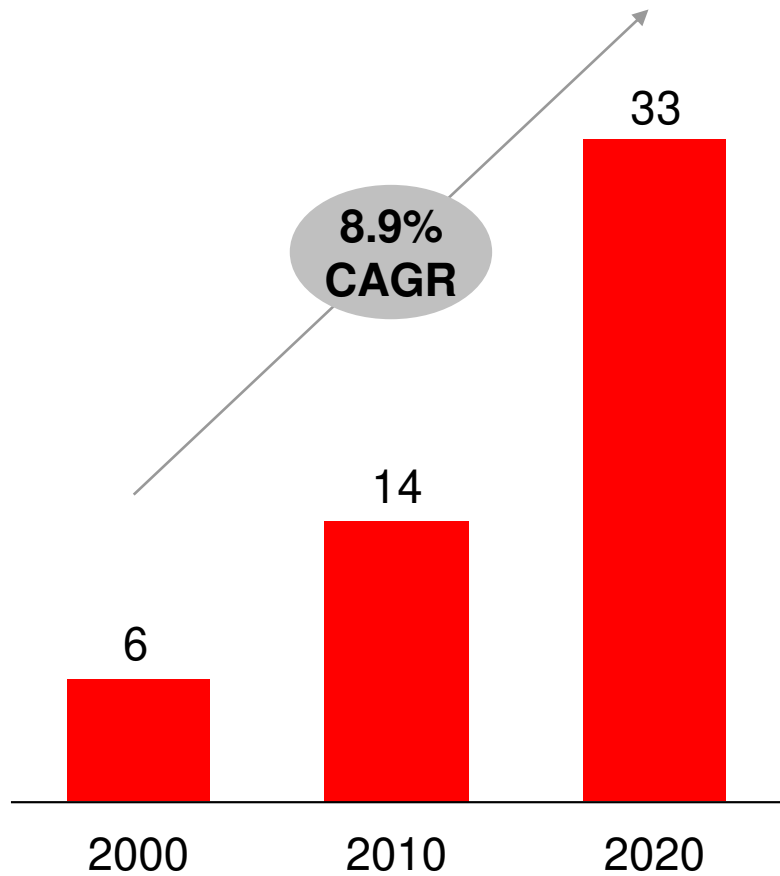
- B** World economy will continue to **rebalance** towards “currently deemed” emerging markets

- C** **Regulation** will continue to shape the financial services industry and, in particular, Global banks’ strategies

A Importance of global connectivity will increase

Trade will continue to grow

Trade growth¹, USDtn



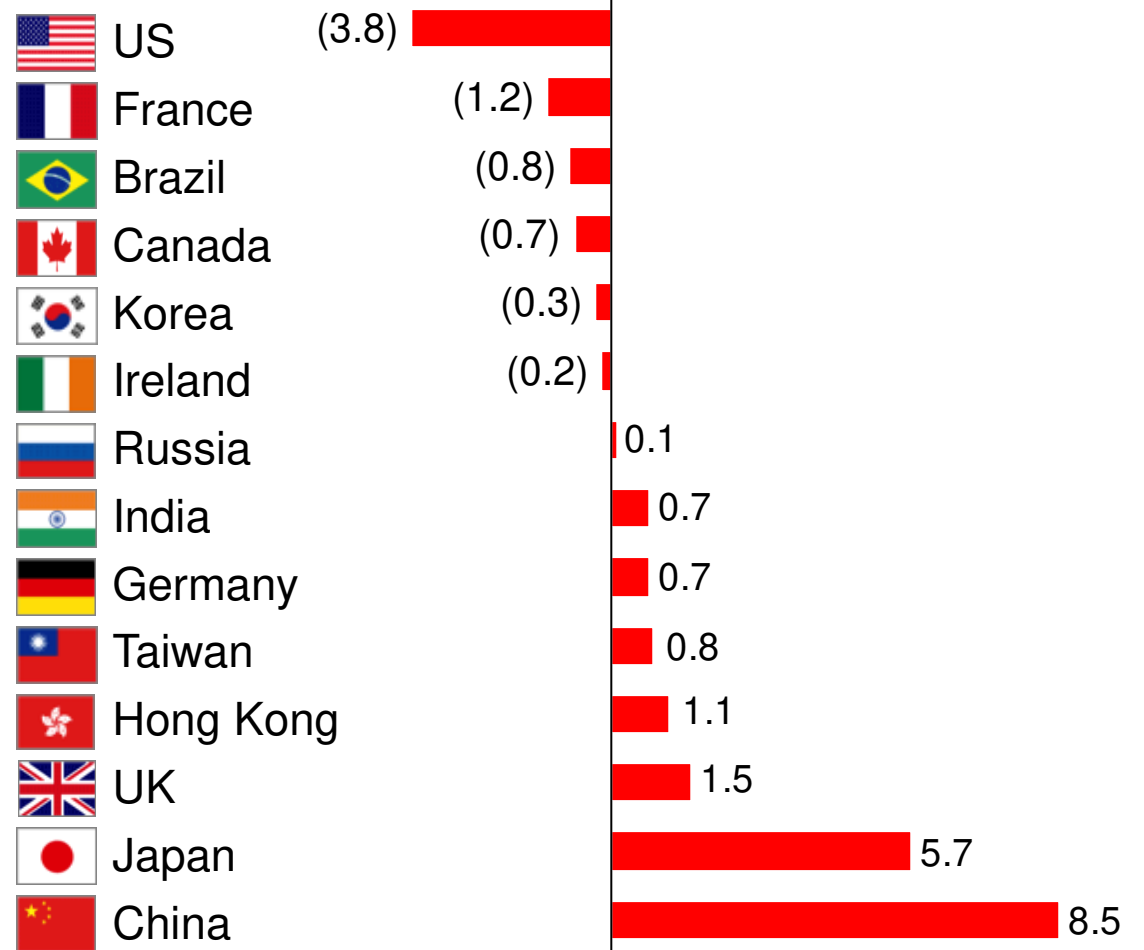
¹ Merchandise Exports

² Positive value means funding surplus, negative value means funding gap

Source: Global Insights, McKinsey & Company and World Economic Forum, 'More Credit with Fewer Crises: Responsibly meeting the World's growing demand for credit' page 49, exhibit 25: 'Funding gap or surplus for selected countries', (http://www3.weforum.org/docs/WEF_NR_More_credit_fewer_crises_2011.pdf)

Imbalances continue to drive capital flows

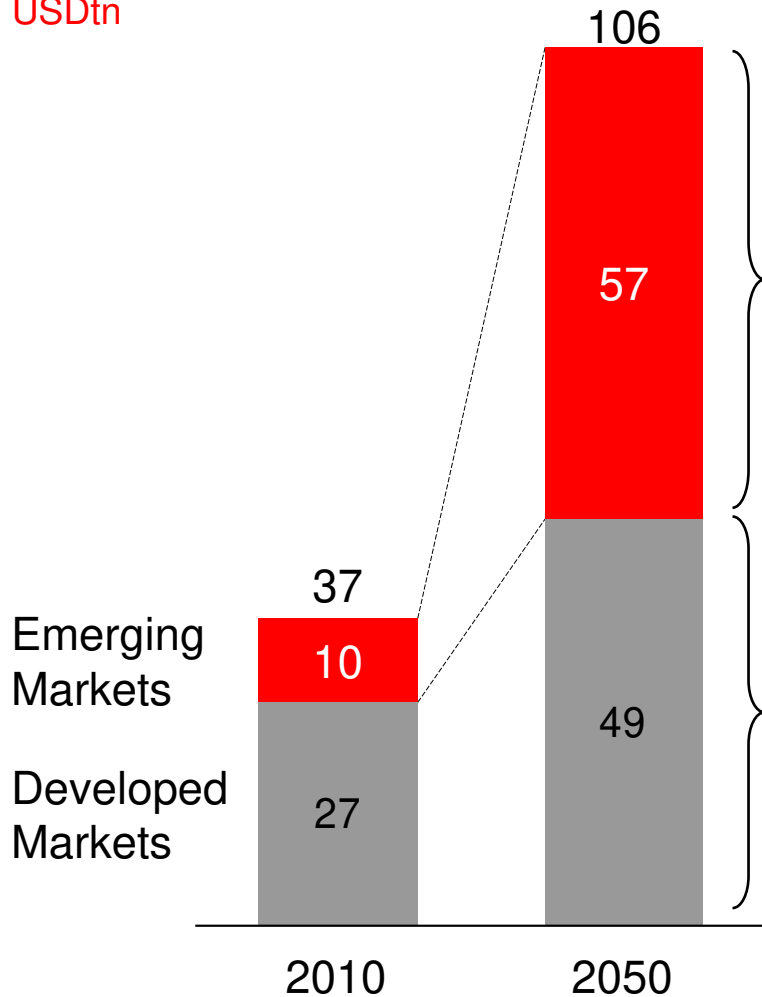
Net funding gap/surplus², USDtn, 2020E



B Rebalancing of the world economy

GDP of top 30 economies

USDtn



Largest countries

	China
	India
	Brazil
	Mexico
	Turkey
	Other 14 emerging
	US
	Japan
	Germany
	UK
	France
	Canada
	Other 5 developed

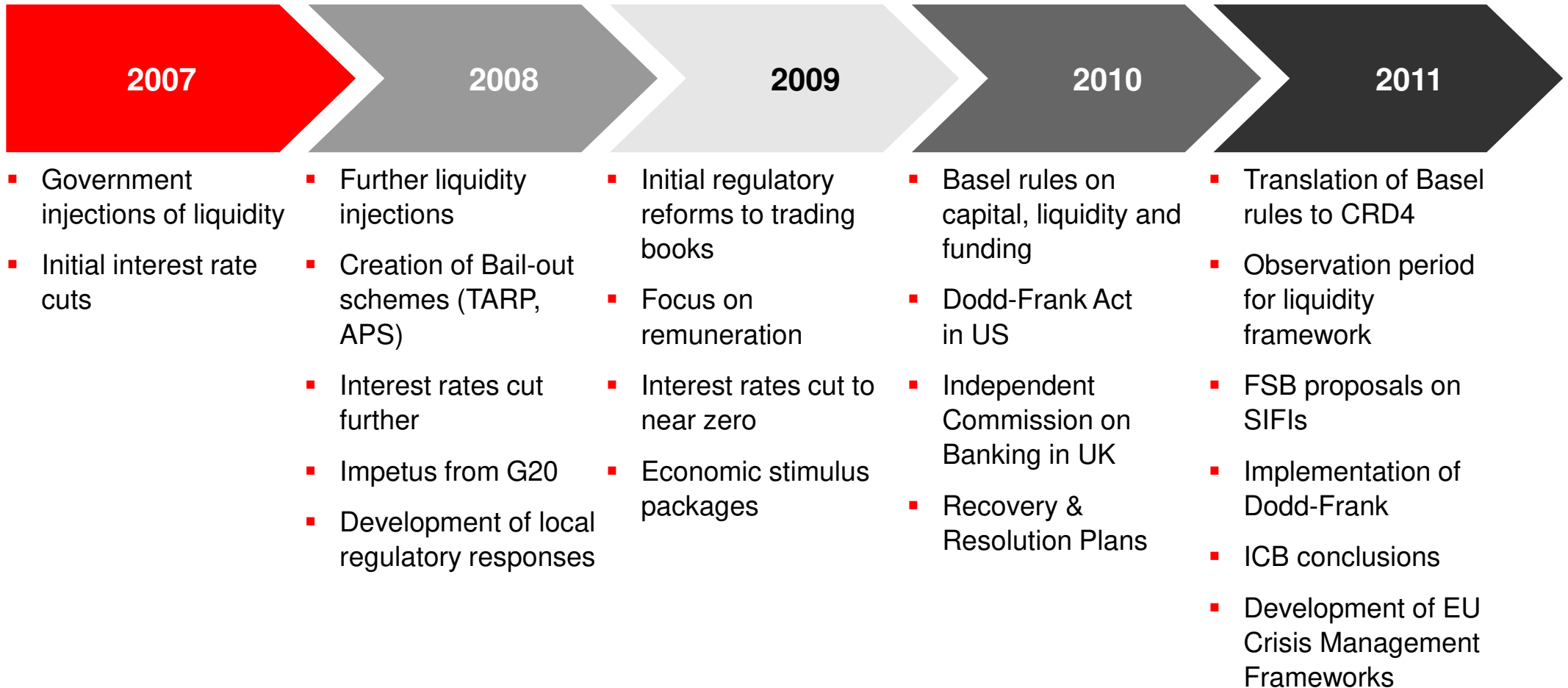
Share of 2050 GDP¹ (%)

	20
	7
	2
	2
	2
	14
	18
	5
	3
	3
	2
	2
	4

19 of the top 30 economies in 2050 will be from currently deemed “emerging markets”

¹ 2050 GDP estimated for top 30 countries, 2050 world GDP estimated by assuming top 30 maintain same share of total world GDP as 2010 of 85%. Source: HSBC – “The World in 2050: Quantifying the shift in the global economy”

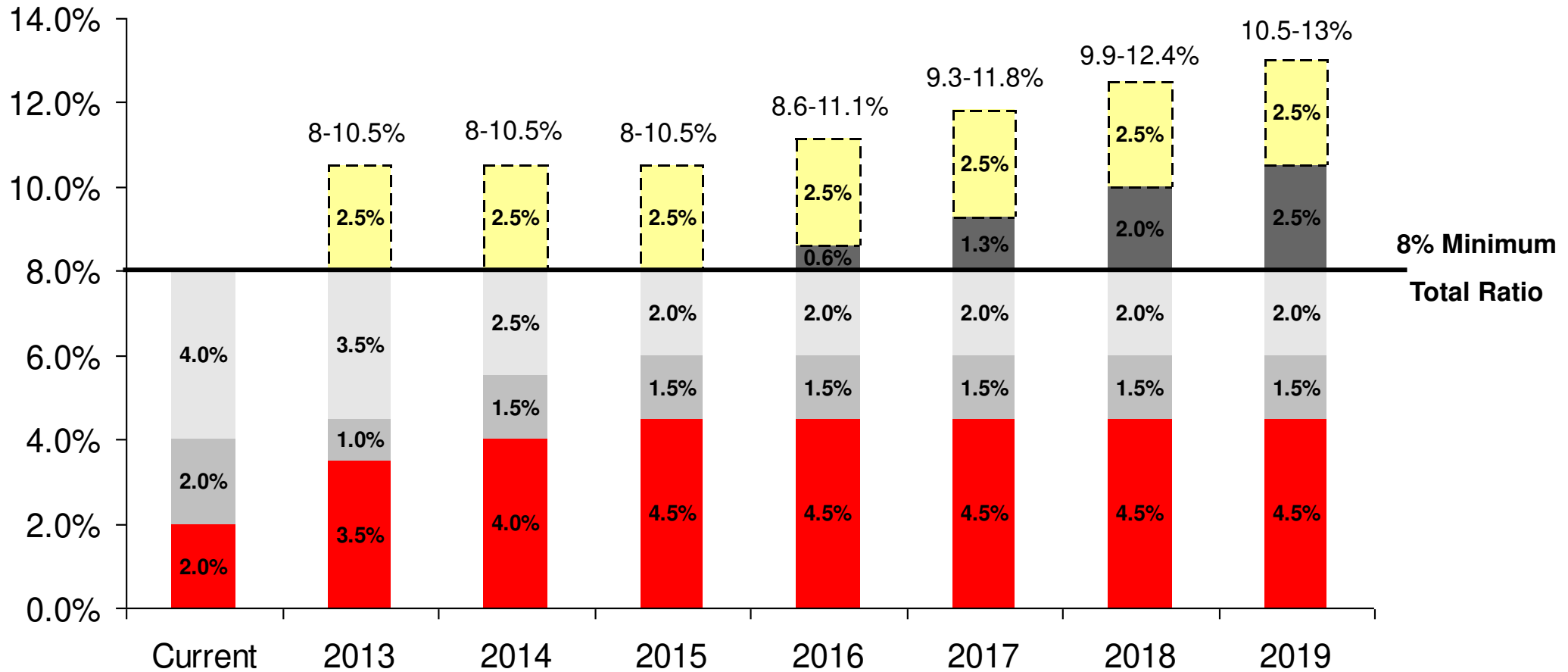
C Intense period of regulatory change will continue



Policies still being agreed with long term implementation

- Basel 3 framework on capital, liquidity and funding has a timetable to 2019 and beyond
 - Both liquidity and funding still subject to observation periods
- Implementation into key national and regional frameworks (such as US and EU) to be completed
 - Heated EU vs US discussion on ‘watering-down’ of Basel 3 but US institutions cannot meet the liquidity requirements
- Current dispute within EU on application of Basel 3 within Europe via Capital Requirements Directive #4 (CRD4)
 - Via Regulation, as proposed by European Commission, gives no local flexibility – opposed by UK, Spain and Sweden
 - Via Directive, allows local ‘gold-plating’ (and possibly ‘tin-plating’) – opposed by France and Germany
- Definition and measures for Globally Systemically Important Financial Institutions (G-SIFIs)
 - Advice from Basel Committee to FSB of capital surcharge of 1.0 - 2.5%, with possible additional 1.0%

Basel 3 – Minimum Pillar 1 Capital Ratios



- Common Tier 1 Capital
- Tier 2 capital
- Counter Cyclical Buffer (up to 2.5%)

- Other Tier 1 Capital
- Capital Conservation Buffer

Note: Ratios DO NOT include potential capital surcharges for SIFIs or Pillar 2 Charges

- Environment and trends
- **HSBC Group priorities and strategic actions**
- Capital, risk and performance management

Like many banks today, HSBC faces important challenges



Regulation and capital Requirements

- Evolving regulation resulting in higher capital requirements which, in light of continued uncertainty, we assume to be 9.5-10.5% Common Equity Tier 1 under Basel III
- HSBC can comfortably meet Basel III capital requirements

Common Equity Tier 1 ratio of 9.5% - 10.5% (Basel III)

Efficiency

- **CER of 55% for 2010** (in Q1 2011, 61%, or 55% excluding notable items and FVOD) is well above target range and unacceptable
- There is a programme of sustainable cost saves planned to bring cost efficiency within the target range by 2013

CER target of 48 - 52%

Profitability

- **ROE of 9.5% for 2010**, with some of the assets not delivering the desired target return (e.g., North America) of 12-15%
- Persistent low interest rate environment (e.g. in USA, UK, Hong Kong) impacting profitability

ROE target of 12 - 15% (Basel III)

Two main elements

This means . . .

International network



1

Economic development/ wealth creation



2

- Presence in network markets that matter for international connectivity
- Businesses that are internationally connected:
 - GBM hub-and-spoke model with global reach
 - CMB provides a full range of commercial financial services to companies in 60+ markets
 - Investment opportunities in fast growing and mature markets
- Wealth creation in most relevant markets (18 key markets)
- Focus on retail banking only in markets where we can achieve profitable scale:
 - Large scale positions (Hong Kong and UK)
 - High growth markets (e.g., Mexico, Singapore, Turkey, Brazil)
 - Leading market shares in small geographies

Strategy provides a clear framework to review our portfolio and achieve higher discipline in capital allocation

1 CMB and GBM Opportunities

Superior network and full product suite...

- Presence in main financial hubs and more than 80 markets
- Deep client franchise in Global Banking (c. 4,000) and Commercial Banking (c. 52,000) in over 60 countries
- Full product suite to support clients, including:
 - Global Markets (FX, Rates, Credit)
 - DCM, ECM and Advisory
 - Payments and Cash Management

... to capture client opportunities

- Multinationals investing in fast growing and mature markets
- Small and mid-sized exporters/importers
- High growth companies gaining access to capital markets
- Governments and Financial Institutions with international and capital needs

CMB and GBM intra-Group connectivity generating USD1bn of additional revenues by 2013



2 In retail banking profit is concentrated on few markets



	Description	RBWM PBT USDm, 2010 ¹	Number of branches
Large scale positions	<ul style="list-style-type: none"> Significant scale in Hong Kong and the UK 	4,141	1,514
Major presences	<ul style="list-style-type: none"> Significant presence in 13 markets with high growth potential including: Brazil, Mexico, Singapore, Turkey, Egypt 	1,020	3,414
Investments	<ul style="list-style-type: none"> Investing for future opportunity in mainland China and India 	(216)	212 ²
Small market leadership	<ul style="list-style-type: none"> Leading market shares in small geographies, including: Malta, Bermuda, Brunei, Panama 	150	114
Others	<ul style="list-style-type: none"> 39 markets, typically subscale Net funding providers to rest of bank 	(244)	420
US	<ul style="list-style-type: none"> HSBC Bank USA, HSBC Finance Corporation 	(2,306)	477

Note: Excluding China Associates

¹ Figures on a Reported basis. Figures exclude Global Asset Management.

² Including 56 InvestDirect outlets

Key execution elements

Actions

In 12 months progress on¹ . . .

I Capital Deployment

- **Five filters driving disposals and closures** of non-strategic and/or underperforming positions/businesses
- **Turnaround** of strategically relevant businesses

- Transactions announced and executed
- Tangible progress in turnaround actions (e.g., US)

II Cost efficiency

- Target **USD2.5-3.5bn in sustainable cost saves** in 3 years, achieving our 48-52% CER target by 2013
- **Simplify and delayer** the organisation

- Material savings identified and being delivered across the 4 main programmes

III Growth

- Revenue growth in **fast growing markets**
- Capture **wealth opportunity** (USD4bn in additional revenues)
- Leverage intra-group **connectivity** between **CMB and GBM** (USD1bn of additional revenues)

- Income growth particularly in Asia and Latin America
- Wealth and GBM/CMB connectivity

¹ From 11 May 2011

I Improve capital deployment – Five filters

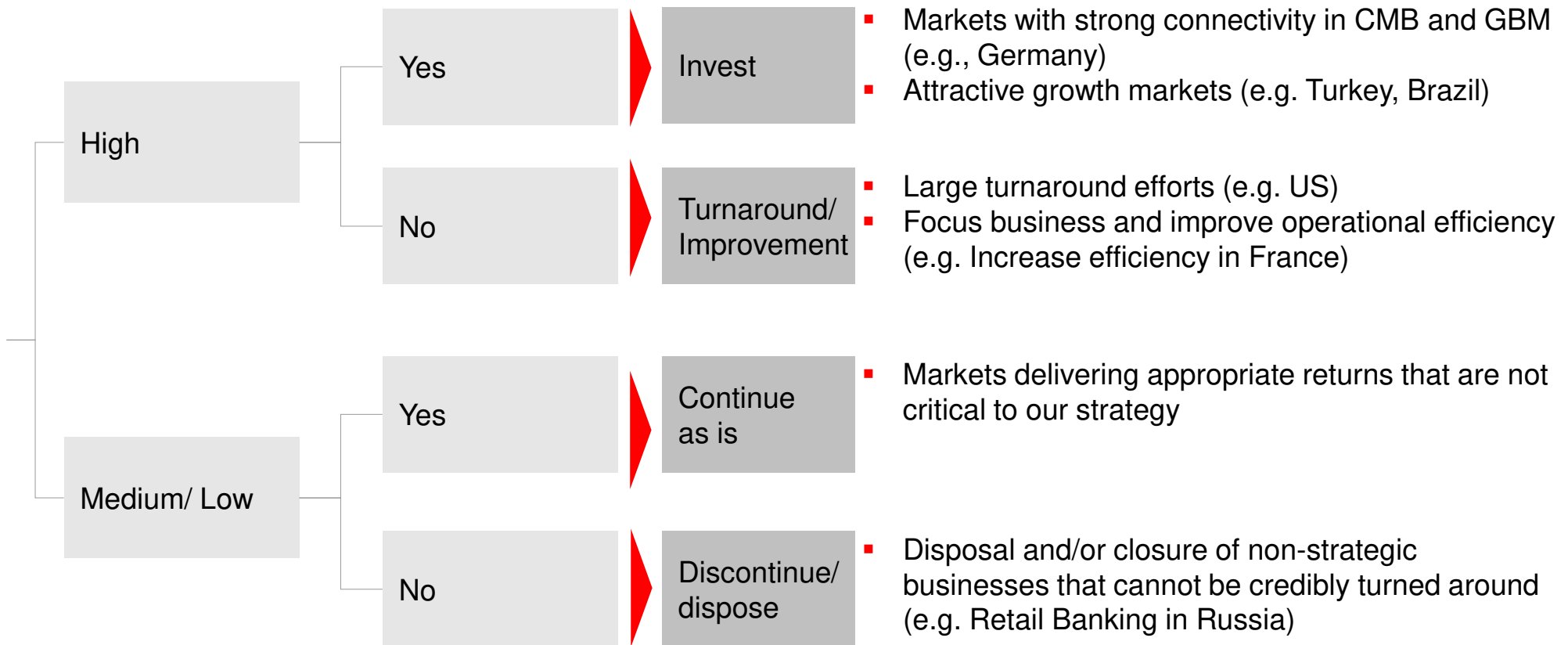
What is the strategic relevance?

- 1. Connectivity
- 2. Economic development

Are the current returns attractive?

- 3. Profitability
- 4. Efficiency
- 5. Liquidity

Resulting actions



II Cost efficiency objectives and approach

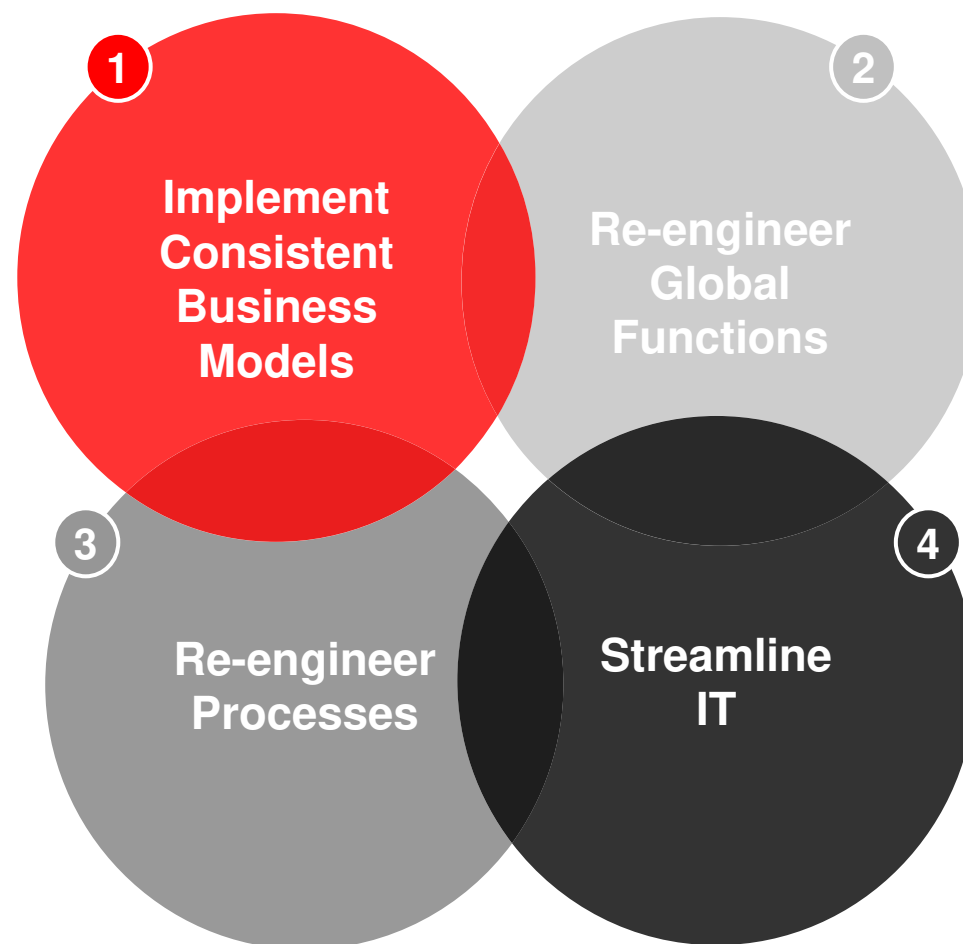
Objectives

- **Improve CER** from 55% to target range 48-52% by 2013
- Support achievement of **positive jaws**
- Become more **dynamic and agile**

Principles

- Sustainable cost saves
- Reduce complexity
- Pragmatically implement best practices
- Build world class business re-engineering capabilities and culture

Approach

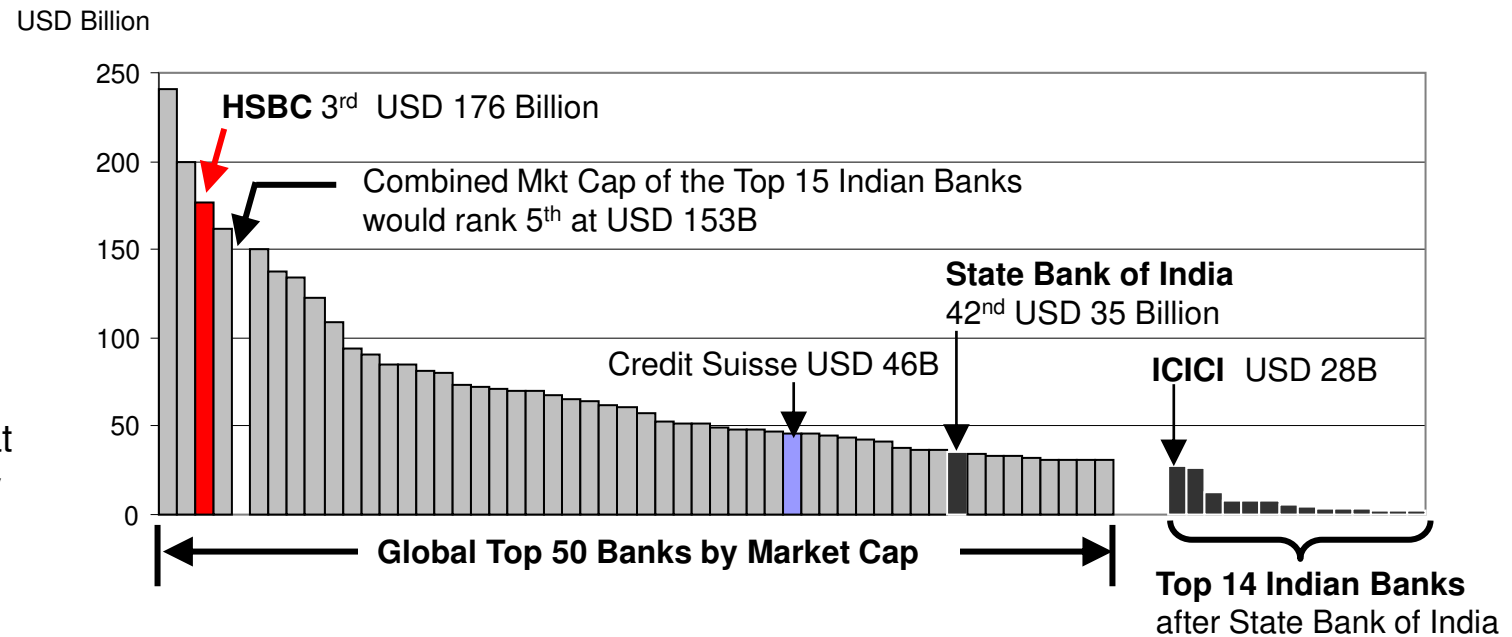


India banking industry in global context



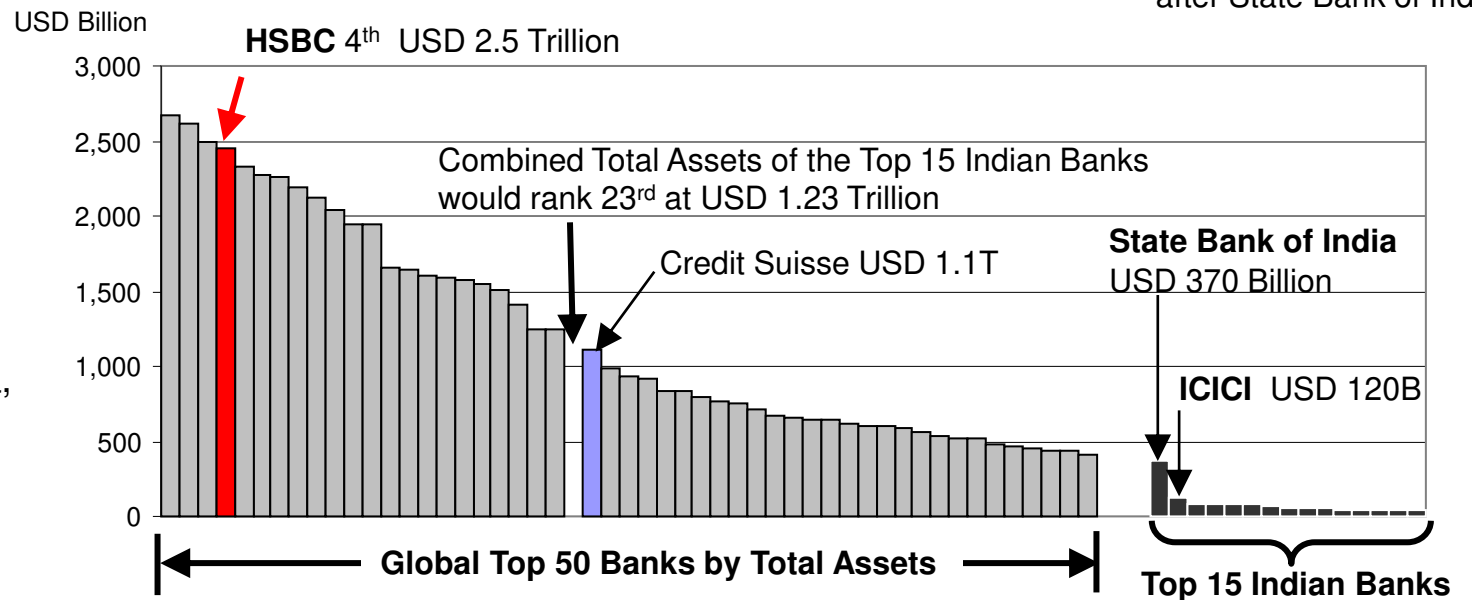
Global Banks by Market Capitalisation

- Only one bank from India (State Bank of India USD35B) is in the global top 50
- Hypothetically, the Combined Mkt Cap of the top 15 banks in India, at USD 153B, would rank 5th globally



Global Banks by Total Assets

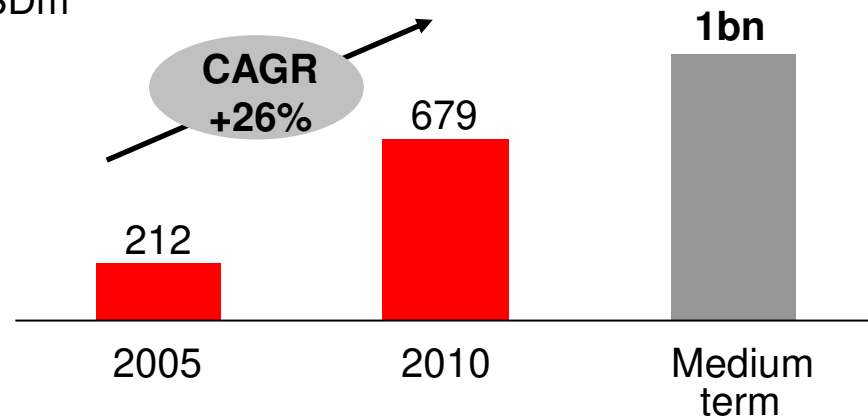
- No bank from India is in the global top 50 by Total Assets
- Hypothetically, the combined Total Assets of the top 15 banks in India, at USD 1.23 T, would rank 23rd globally



III Growth example: India strategy – well positioned across business lines to reach USD1bn PBT

PBT aspiration

USDm



Key actions

Corporate: Financing led strategy to build domestic corporate franchise serving our local and international customers' needs

Retail: Continuing to expand distribution to capture the retail opportunity e.g., RBS business acquisition³

Key opportunities

- GDP expected to grow at over 8%, with middle class households growing 10% CAGR up to 2025¹
- Wholesale banking revenue pool expected to grow 2.5x to USD40bn in 2015¹
- Retail and Corporate profit pool related to Indians based overseas estimated at USD4bn²

HSBC position

- HSBC is present in 50 cities with 106 outlets (driven by acquisition of InvestDirect in 2008)
- Strong GBM and CMB franchise (PBT grew 3x from 2005 to 2010)
- HSBC has a presence in most countries that have significant overseas Indian population

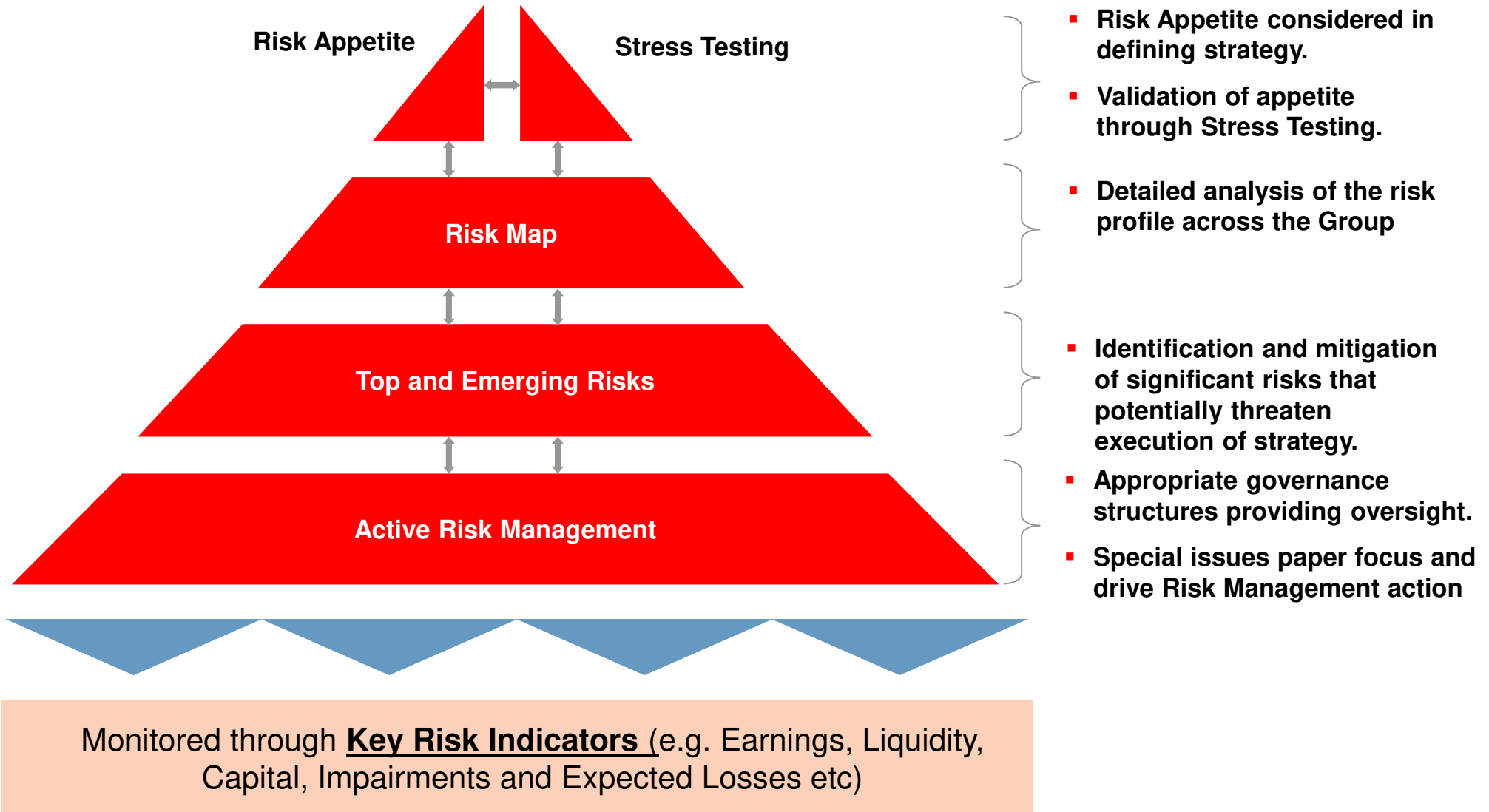
¹ Estimated by McKinsey

² Estimated by HSBC

³ Subject to Regulatory approval

- Environment and trends
- HSBC Group priorities and strategic actions
- **Capital, risk and performance management**

Risk Appetite drives other key Risk Governance processes



Potential Basel 3 impact

	Basel II → Basel III impacts	Probable timing	Potential bp impact	
RWAs impact	VaR, Securitisation and correlation trading	By 2013	40 to 45	100 to 115bp
	CVA charge and financial correlation	By 2013	60 to 70	
Dual impact	Threshold deductions and other	2013 to 2018	70 to 80	95 to 110bp
	DTA – loss carried forward	2014 to 2018	25 to 30	
Capital impact	AFS and other reserves	2014 to 2018	5 to 10	55 to 75bp
	Expected loss deduction	2014 to 2018	25 to 30	
	Pension filter	2014 to 2018	15 to 20	
	Partly excluding minorities	2014 to 2018	10 to 15	
			250 to 300bp	

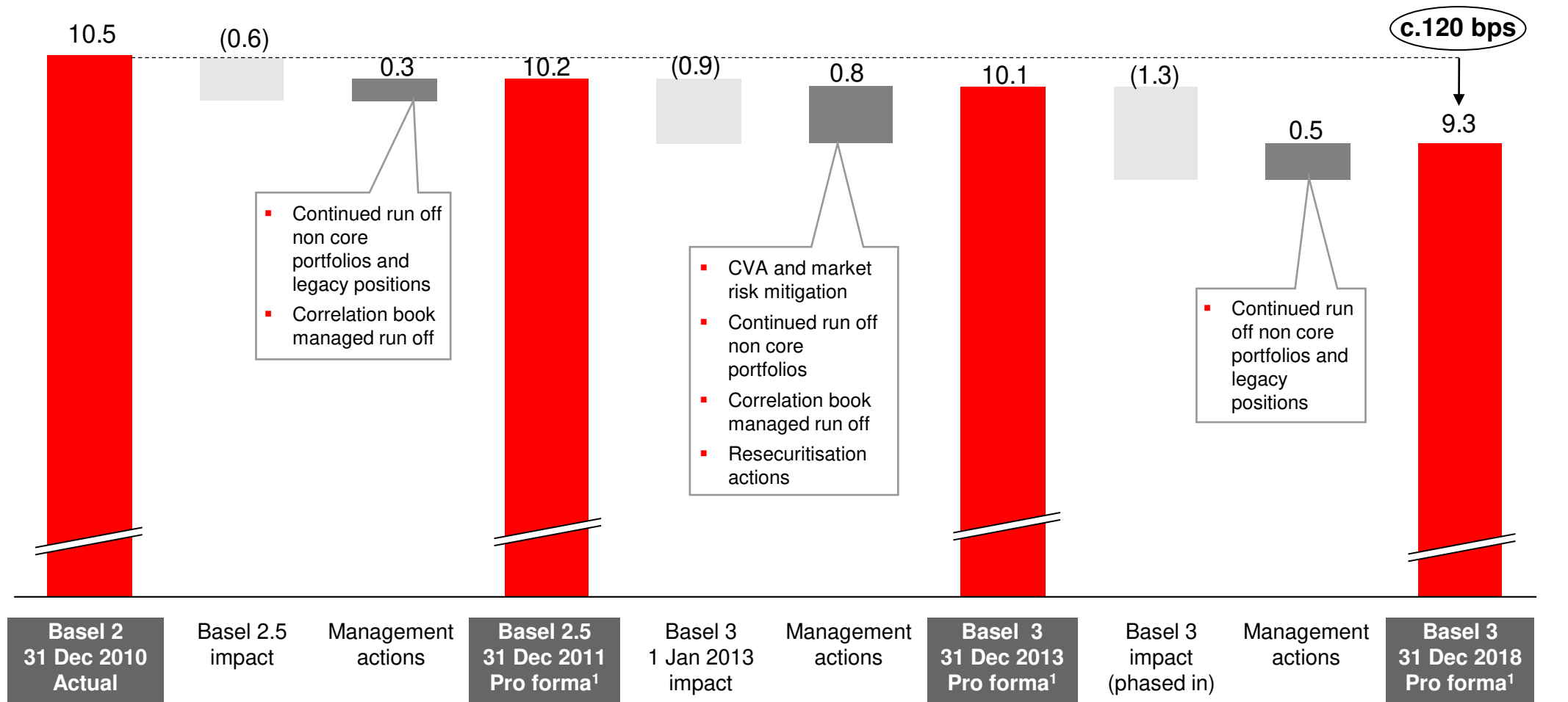
Notes:
Impact evaluated based on 31/12/10 positions, assuming full one time implementation, see page 8 2010 Annual Report and Accounts

Phased Basel 3 implementation and mitigations (Pro-forma)

Basel II → Basel III detailed build-up

■ Impact of mitigations and revised estimates

Core/Common equity tier 1 capital ratio, % (pro-forma)



¹ No capital generation, no business growth included

Capital

Capital informs the risk capacity and risk appetite of banks
Effective capital management involves considering different types of capital



There are four categories of capital which HSBC, or any other bank, needs to manage

Market value
of equity

Focus on Return on Equity (ROE), Return on Risk Weighted Assets (RORWA) and Cost Efficiency Ratio as benchmark for assessing Group performance

Invested
capital

HSBC must earn a return on its invested capital which exceeds its cost of capital i.e. it must generate economic profit

Regulatory
capital

Requirements must be met on a Group (Financial Services Authority - FSA) and local regulation basis at all times. Acts as a business constraint and therefore needs to be modelled and factored into capital allocation decisions

Economic
capital

Provides a risk-sensitive view of capital and informs risk/return performance and prudential assessments

HSBC manages the demand and supply of capital in an aligned manner consistent with a defined **risk appetite**

HSBC's regional, global businesses and functional matrix

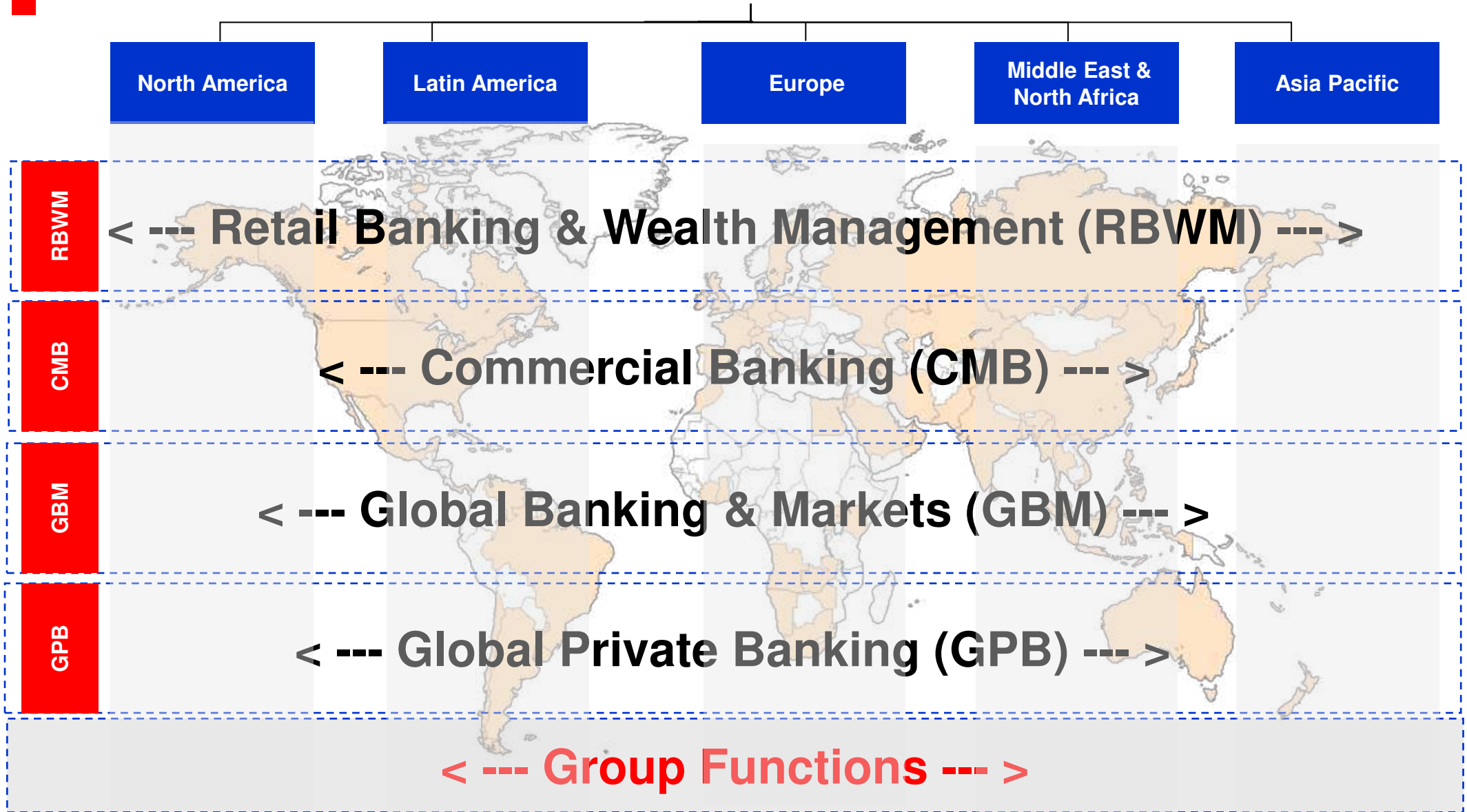


Illustration of HSBC Performance Scorecard



2011 PERFORMANCE SCORECARD (Business/Region)							
FINANCIAL (50%)			NON-FINANCIAL (50%)				
	2011 Target	2011 YTD	Assessment		2011 Target	2011 YTD	Assessment
Profit Before Tax (US\$m)				Strategy Execution			
Cost Efficiency Ratio (%)				Compliance and Reputation			
Return On Equity (%)				People and Values			
Core Tier 1 Capital (%)							
Dividends (%)							
Dividends (US\$bn)							
VALUES							
<ul style="list-style-type: none"> Adherence to Group Values cover the basics of running a sound bank. Overall performance is to be judged on performance outcomes <i>and</i> adherence to Group Values. 							

Discussion: how does this compare to the 9 metrics used by Indian public sector banks?

HSBC Long Term Incentive Plan (LTIP)



2011 PERFORMANCE SCORECARD LTIP		
FINANCIAL (60%)		NON-FINANCIAL (40%)
	Long Term Target	2011 Target
Return On Equity (%)	12-15	Strategy Execution
Cost Efficiency Ratio (%)	48-52	Brand Equity
Capital Strength (%)	>10	Compliance and Reputation
Progressive Dividend Payout within 40-60% Range (%)	40-60	People

VALUES
<ul style="list-style-type: none"> Adherence to Group Values cover the basics of running a sound bank. Overall performance is to be judged on Group performance outcomes <i>and</i> individual adherence to Group Values.

Note: same scorecard for the Long Term Incentive of top 50 employees (0.005% of total)

Linkages through the scorecard cascade

Using "Costs control" as an example to demonstrate tailoring from LTIP to 1 and 2 levels below Group CEO

