

Interim Results Announcement H1 2022

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MARK TUCKER, GROUP CHAIRMAN: Good morning or good afternoon, wherever you are in the world. I'm really delighted that we're in Hong Kong today for our interim results announcement for the first time since the COVID-19 virus struck the world. I'm here today with Noel and Ewen. They will take you through the presentation shortly, and Noel will then lead the Q&A. As well as today's results, we're also giving plenty of time to meeting with our customers and investors face to face, and I'm very much looking forward to meeting with our Hong Kong shareholders tomorrow. We have always greatly valued their feedback and engagement and we look forward to seeing them in person.

There have been reports in recent months about ideas for alternative structures for HSBC. The board has been fully engaged in examining these ideas in depth, and we will continue that thorough examination. Noel will discuss this in more detail during the presentation.

The board firmly believes that, as these results clearly demonstrate, HSBC's strategy is working, and expect that it will deliver very good returns over the coming years. For 157 years, we have followed trade and investment flows to support our customers as they fulfil their financial ambitions. We have used our deep experience and strong global relationships to help our customers to navigate the world. Today we remain steadfastly focused on our core purpose of opening up a world of opportunity.

Our model is increasingly relevant to individuals and to companies of all sizes and whose financial ambitions span multiple countries and regions. Our transformation has enabled us to emerge from the pandemic a stronger bank, and well positioned to capitalise on the current interest rates cycle. And very few banks can rival our ability to connect capital, ideas and people through a global network that facilitates the international collaboration required to succeed in today's world.

The focus for the board and the management team is on delivering our strategy precisely because it is the best way for us to support our customers and to improve returns. With that, let me hand over to Noel.

NOEL QUINN, GROUP CHIEF EXECUTIVE: Thank you, Mark, and good afternoon to everyone in Hong Kong. It's great to be here to present our half-year results. And good morning to everyone in London. Before I turn to progress against our strategy, a brief reminder of the context. As Mark said, our purpose as an organisation is "opening up a world of opportunity". These words are a product of extensive consultation with our customers, our colleagues, about who we are and what we do, and I strongly believe that our strength as a global institution comes from our ability to connect the major trading blocs of the world.

I will come back to the value of our connectivity and strategy later on. The next slide sets out the key points that we're going to cover in our presentation today. First, we've had another strong performance in the second quarter. I'm pleased that reported revenue grew by 2% on last year's second quarter and was up 12% on an adjusted basis. Adjusted profits before tax were up 13% on the same period last year and continued strong cost control led to positive adjusted jaws of 12%.

Second, we've made good progress with our transformation programme. If you look back a few years ago, we had loss-making businesses in the US and Europe, and capital was being used inefficiently. We have structurally repositioned our portfolio, our businesses and our operating model for higher returns. The two most material adjustments in our portfolio have been the exit

and wind-down of non-strategic assets and clients in the US and Europe, and the strong impetus behind organic and inorganic growth in Asia, especially in Wealth and Personal Banking. This repositioning effect is starting to pay off in terms of growth and returns, as these results show.

Third, it is the benefit of transformation and the tailwinds from higher interest rates that allow me to announce some ambitious new targets and underpinning guidance even against the challenging economic backdrop. After delivering an annualised return on tangible equity of 9.9% in the first half, we are confident of delivering at least 12% from 2023 onwards. This would represent our best financial performance for a decade.

Finally, as a result, we are providing more specific guidance of a 50% dividend pay-out ratio for 2023 and 2024. We understand and appreciate the importance of dividends to all our shareholders, so we will aim to restore the dividend to pre-Covid levels as soon as possible. We also intend to revert to quarterly dividends in 2023.

Let me now walk you through the progress we've made in the first half of this year in transforming the bank. In Asia Wealth, our investments over the past few years are gaining traction. We've made a series of bolt-on acquisitions to accelerate our progress. In the first half, we completed the acquisition of AXA Singapore, and we remain on track to complete the acquisition of L&T Investment Management in India, and in mainland China we continue to build momentum on the back of 17 new licences and regulatory approvals gained since the start of 2020, seven of which were in the first six months of this year. We've got strong revenue momentum across all of our businesses, with 4% of the adjusted revenue growth in the first half. After turning the corner on revenue back in 2021, normalising interest rates give us confidence in the returns trajectory for the coming years, as we will explain later.

We have also got good cost control, with adjusted costs stable in the first half despite inflation and higher spending on technology. We had an annualised return on tangible equity in the first half of 9.9%. We have now made cumulative RWA saves of \$114 billion and remain on track to exceed \$120 billion as we continue to exit assets and clients that do not add value to our international proposition. Our CET1 ratio was 13.6%, and we aim to manage back to within our target range, 14% to 14.5%, during the first half of 2023. Our capital allocation to growth opportunities in Asia, and Wealth and Personal Banking also showed good progress.

We have a strong focus across our network today. When you combine exiting unprofitable businesses and underproductive RWAs with tighter costs and an impetus for growth, you get much better geographic performance, with every region profitable in the first half. One of the standout performers was HSBC UK, which contributed \$2.5 billion of adjusted profits, up 15% on the first half of last year. Many of you heard about the fantastic job that Ian Stuart and the UK team are doing at the recent investor day. If not, please do look at the materials on the website.

Looking forward, our transformation also means we can expect the current rates cycle to bring higher returns than previous rates cycles because we have more liquidity, less risk and much higher operating leverage. The level of surplus deposits we hold means we're very well positioned to benefit as higher rates kick in. We also now have less risk in our two key books, the retail unsecured loan book and the SME lending book. We have around \$91 billion of Business Banking deposits in Hong Kong and around \$55 billion of Business Banking deposits in the UK at very low A/D ratios, and we have outperformed our peers on cost management in recent years.

The next few slides cover our four strategic pillars, starting with the focus on our strengths. Our market-leading Commercial Banking franchise had a very strong first half. Revenue was up 14% on last year. Within that, it was particularly promising that there was fee income growth of more than 12%. Trade revenue in Commercial Banking increased by nearly \$200 million or 20%, driven by a 25% increase in average trade balances, as clients trusted us to help them navigate supply-chain shifts. GLCM was up 42%, with a strong benefit from interest rates normalising, and by geography, every region performed strongly. Revenues were up 19% in the UK, up 5% in Hong Kong, up 18% in the rest of Asia and up 12% in the rest of the world.

In Wealth and Personal Banking, the impacts of the transformation I described is particularly evident. Net new invested assets in Wealth grew by 9% in the first half. In Asia, we achieved

significantly more positive dollar growth than was reported recently by our European wealth-management peers, and it was great to see the value of new business in our Asia insurance franchise grow by 41%, all despite adverse market conditions. Revenue in Wealth and Personal Banking was stable but, excluding market impacts and a gain on pricing updates on policyholders' funds, it was up by 7%. Personal Banking had a very strong half. Lending balances were up 4%, driven by a strong UK mortgages performance and, looking at revenue by geography, excluding market impacts and the insurance gain, the UK was up 22%, Mexico was up 16%, while Hong Kong remained resilient, down only 1% despite the impact of Covid restrictions. All of this underlines the way we've structurally repositioned the business. We should now get the benefit of normalising rates on top of that.

Global Banking and Markets also performed very well in the first half, reflecting our differentiated and diversified business model. Strong revenue performances in transaction banking and our Markets business were driven by rate rises and continued good levels of client activity. Collaboration between Global Banking and Markets and Commercial Banking is a priority, so I was particularly pleased to see these collaboration revenues increase by 14%. Back in February, I talked about the proportion of Global Banking and Markets client business booked in the East but originated in Europe and the Americas. In the first half, this revenue grew by around 8% on the same period last year, underlying the strength of our connected franchise. We will continue to invest in coverage and build share in connecting capital and trade flows between the world's major economic blocs.

Digitising HSBC continues to improve the client experience and make our processes more efficient. We've continued to raise our spending on technology, with more than half spent on change-the-bank initiatives to drive growth and efficiencies. This is in spite of the commitment to keep our overall costs stable in 2022. We've more than doubled the proportion of our agile workforce over the past year, which we expect to translate into a much faster release frequency for new features and propositions. Our cloud adoption across public and private cloud continued to increase beyond 30%, with an ambition to go much further. And, across trade, HSBCnet and retail mobile, penetration levels and volumes increased materially, with ambitions to grow them even further.

The next slide covers our last two strategic pillars. First, we're continuing to build a dynamic and inclusive culture. We remain on track to achieve our revised target of 35% of senior leadership roles filled by women by 2025. The total number of hours spent by colleagues learning about sustainability, digital and data increased sevenfold, reflecting the increased priority placed on future skills. And to give you an example of how we're opening up a world of opportunity for our people, we're rolling out a talent marketplace which uses AI to match colleagues with short-term projects and learning based on their skills and ambitions.

Then, on transition to net zero, the amount of sustainable financing and investment that we provided and facilitated was stable on the first half of last year despite the overall market for green, social and sustainability and sustainability-linked bonds being down in the first half. The overall amount of sustainable finance and investment provided and facilitated since the start of 2020 now stands at more than \$170 billion, well on our way towards our target of up to \$1 trillion by 2030.

The next slide shows why we're confident of keeping adjusted costs stable in 2022, and our ambition is to keep cost growth to around 2% in 2023 despite strong inflation headwinds. It comes down to three things. First, good cost discipline across the whole group. Second, our efficiency levers. We're reducing the global real estate footprint, reducing our global retail infrastructure, using more automation and reducing our operations headcount. We're still only partway through these journeys, with an ambition to achieve even greater savings. Finally, we will continue to see the impact of our current transformation programs into next year. The flow-through benefits into 2023 are also a big component and will be an important help to offset inflation.

This brings me to expectations for the rest of 2022 and 2023. I've explained how we've structurally repositioned the business to achieve higher returns once rates normalise. Despite the uncertainty in the macroeconomic environment, we're expecting at least \$37 billion of net interest income in 2023, which is a significant uplift on the \$31 billion-plus we expected in 2022. We're aiming to keep cost growth at around 2% in 2023, which we fully expect to be able to do for the reasons I've explained.

Given all of this, we are materially upgrading our returns guidance. We are confident of achieving a return on tangible equity of at least 12% from 2023 onwards. As a result, we are also providing more specific guidance of a 50% dividend pay-out ratio for 2023 and 2024. We aim to restore the dividend to pre-Covid levels as soon as possible, and we will also revert to quarterly dividends from 2023 onwards. I'll speak to a few more slides at the end but let me now hand over to Ewen to take you through the numbers in detail.

EWEN STEVENSON, GROUP CHIEF FINANCIAL OFFICER: Thanks, Noel, and good morning, or afternoon, all. As Noel and Mark have said, it's really great to be in Hong Kong for these results. We had another strong quarter, reported pre-tax profits of \$5 billion while down 1% on last year's second quarter. This marks a strong core operating performance. Compared to the second quarter of last year, adjusted revenues were up 12%, including net interest income up 20%. With operating expenses flat, we had 12% positive jaws. Adjusted pre-tax profits were up 13% and profits attributable to ordinary shareholders were up 62%

Credit conditions remained benign in the quarter. ECLs were a \$448 million net charge compared with a net release last year. We benefited from a \$1.8 billion deferred tax asset credit in the quarter, reflecting a recognition of brought-forward tax losses in the UK, given the improved profitability outlook. We now expect a 2022 effective tax rate of around 10%, reverting to a more normalised effective tax rate of around 20% in 2023.

To remind you, for 2022 dividend modelling purposes, please exclude the DTA gain and the French loss on disposal, being non-cash significant items, but include the \$3.4 billion of costs to achieve we expect to spend this year and other significant items. Our common equity tier 1 ratio was 13.6%. Tangible net asset value per share was \$7.48, down 32 cents on the first quarter mainly due to FX impacts but also to the fourth quarter 2021 dividend payment. And we've announced an interim dividend of 9 cents per share, up 2 cents on the first half of 2021.

On the next slide, there was a strong adjusted revenue performance across all our global businesses. Wealth and Personal Banking revenues were up 5% overall and up 19% if you exclude \$700 million of adverse market impacts and insurance. Underlying this, Personal Banking had a strong quarter, revenues up 20%, reflecting both rate rises and balance sheet growth. Commercial Banking was up 19%, with growth across all core products due to improved margins and balance sheet growth and revenues driven by collaboration with Global Banking and Markets. Global Banking and Markets revenues were up 15%, mainly due to Markets and Securities Services and Global Liquidity and Cash Management. Net fee income was down 4%. The decline in fees from Wealth and Investment Banking was partly offset by the \$100 million increase in Global Liquidity and Cash Management and trade fees, underlying the benefit of our diversified business model.

On slide 17, net interest income was \$7.5 billion, up 20% against last year's second quarter on an adjusted basis. On rates, the net interest margin was 135 basis points, up nine basis points on the fourth quarter and up 16 basis points compared with the fourth quarter last year, as higher asset yields more than offset increased liability costs. And on volumes, we had underlying loan growth in the quarter of 5% annualised, but we saw a decline in average interest-earning assets due to FX. Based upon current FX and the consensus rates outlook, we now expect net interest income of at least \$31 billion for 2022 and at least \$37 billion in 2023, as we return to a more normalised rates environment.

On the next slide, we provide some build-up to our net interest income forecasts on the rates assumptions. As I said, our forecasts today are based on current FX rates and the current consensus rates outlook. As you know, we've low pass-through rates at the moment, but we expect these to increase going into 2023. On volumes, we're forecasting mid-single-digit loan growth in 2023.

Turning to slide 19, we reported a net charge of \$448 million of ECLs in the quarter, or 17 basis points. This included a further \$140 million relating to our mainland China commercial real estate portfolio. Outside of this one specific portfolio, the overall quality of our book remains good. Stage 3 loans, as a percentage of total loans, remain stable at around 1.8%. At this stage, we're not seeing signs of portfolio stress across our key early warning indicators and defaults in July remained low, but we continue to monitor the situation closely. While the first-half ECL charge was only 21 basis points, we continue to expect ECLs to normalise towards

30 basis points of average loans for the full year, with the core driver of this the risk of further deterioration and forward economic guidance rather than any sharp upturn in stage 3 losses.

Turning to the next slide, second quarter operating expenses were stable versus the same period last year, as cost savings and reductions in accrued variable pay offset the continued increased investment in technology and growth. We made a further \$500 million of cost programme savings during the second quarter with an associated cost to achieve of \$600 million. As Noel said, we remain on track for stable adjusted operating expenses this year. Assuming FX remains at June levels for the remainder of 2022, that would be around \$30.5 billion of operating expenses.

We're also on track to achieve the top end of our three-year \$5 billion to \$5.5 billion cost savings target and now expect to see a further \$1 billion of cost savings from this programme flow through to 2023, which will be a material mitigant against the higher inflation we're seeing. As part of this cost programme, we've now spent \$4.6 billion of our \$7 billion cost-to-achieve budget that ends in the fourth quarter. We still expect to spend the remaining \$2.4 billion during the second half of this year. For 2023, despite the inflationary trends we're seeing, we're still aiming for cost growth of around 2%. The environment is highly volatile, but we do not intend to allow the yield curve to weaken our commitment to cost discipline.

Turning to capital, on slide 21, our common equity tier 1 ratio was 13.6%, down 50 basis points on the first quarter. This included underlying risk-weighted asset movements from lending growth and data and methodology enhancements, post-tax fair-value losses through other comprehensive income as interest rates rose and increased threshold deductions as common equity tier 1 capital fell. We expect our common equity tier 1 ratio to fall further during the third quarter. This includes the announced sale of our French retail banking operations, which, based on current FX rates, is expected to have an impact of around 30 basis points. We expect common equity tier 1 to recover materially in the fourth quarter back towards 14%, given additional capital management actions we're now taking, and then be back within our 14% to 14.5% target range during the first half of 2023.

So, in summary, this was a strong quarter. We're firmly on track to achieve significant improved operating performance, returns and distributions from 2023 onwards. With interest rates rapidly normalising and a post-Covid recovery in most markets, we're seeing strong revenue growth, up 12% on a year ago. With continued cost discipline, we've achieved a 12% operating jaws this quarter. While not complacent, the experience of our credit portfolio remains benign.

Based upon the normalisation of interest rates, with at least \$37 billion of net interest income in 2023 and the continued core operating performance improvement we're driving, we're raising our expectations for 2023 and beyond to a return on tangible equity of at least 12%, and on the back of this we expect to see a material uplift in distributions from 2023 onwards.

With that, back to Noel for a few closing comments.

NOEL QUINN, : Thank you, Ewen. I'd like to end with a few slides before Q&A. When we began to accelerate our strategy in February 2021, one of our four strategic pillars was to focus on our strengths. As you have seen from the material today and throughout our history, we have no greater strength than our ability to bridge capital and trade flows between the major economic blocs of the world.

We're the world's leading trade bank, one of the largest payments providers globally and one of the largest FX houses in the world. And even as trade flows have changed and supply chains have shifted, we've taken market share in trade because our network means we can go wherever trade goes. We also command a 20% wallet share of wholesale banking client business from Europe, the Middle East, and the Americas into Asia.

Outside of revenue, our international model has also started delivering synergies in our cost base, particularly through digitisation, where we can "build once, deploy globally" at much lower costs, and there are also capital and funding synergies through the greater diversification of our portfolio and the interconnectivity within it.

In the past investors could not fully assess all that value because parts of our portfolio dragged down the overall returns below the cost of capital, so the work we have done over the past few

years to tightly control costs, reduce capital allocated to low-return domestic-orientated businesses and increase investment in higher-growth higher-return geographies in Asia and in businesses such as Wealth will allow us to demonstrate the value of our international strategy much more clearly, as is evident in our forward guidance of at least 12% returns in 2023 and beyond.

International connectivity is core to our entire value proposition, from clients to employees, and has contributed to our improved returns. 45% of our wholesale client business is booked cross-border and a large proportion of the revenues booked domestically for wholesale clients comes to us because of the business we do for those clients overseas, and we will continue to grow that number. Similarly, in Wealth and Personal Banking, international is the most attractive and fastest-growing segment. A product like Global Money and our Wealth platforms, which are some of our highest-return propositions, are specifically designed to capitalise on our international connectivity for our retail and Wealth customers.

You will continue to see more propositions from us in this space, and that's because the average international customer revenue is around double the average domestic-only customer. In addition, in a highly competitive talent marketplace, especially in Asia, our internationalism is core to our employee value proposition and how our colleagues think about us.

There has been a debate recently about our international model and specifically whether alternative structural options would create more value for our shareholders. As you would expect, we have considered many of these options over recent years. More recently, we have updated our analysis with the benefit of independent third-party financial and legal advice. It has been our judgment that alternative structural options will not deliver increased value for shareholders. Rather, they would have a material negative impact on value and our current strategy is the fastest and safest way to get to higher returns and dividends we all want to see.

When considering different structural options for the bank, we need to make judgments on a range of factors which we think would materially impact valuation outcomes. Clearly, the primary factor is about disruption, too, and the potential loss of the international synergies I just highlighted, but it's not only about synergies. There are significant costs and execution risks that would need to be considered for any alternative structural option. Past experience in the market has evidenced that carving out a relatively small European bank in a single market can take more than \$2 billion, and, even then, has a high risk of failure, so you can understand the risk of standing up separate entities for a franchise of our size.

I won't go through all the points on the slide. Suffice to say the costs are material. There would be significant execution risk over a three- to five-year period when clients, employees and shareholders would all be distracted and impacted, and there are obvious day-one risks around capital distribution and client exits. Another point that comes up with investors in this discussion is our geopolitical positioning. As a global bank, we engage and maintain strong relationships with governments and regulators around the world.

Our international role, our importance to global trade and our homes in London and Hong Kong underpin our relationships in both hemispheres, and our customers have trusted us for 157 years to help them to navigate the world as it has changed. I am putting the factors that we consider when assessing alternative strategies in the public domain so all our shareholders can understand the value of our international structure and our strategy.

So, in summary, we've explained today how our strategy will generate significant value for our shareholders. We remain focused on our strengths, of which international connectivity is at the top. Our UK and Hong Kong franchises are performing very well, and we are shifting capital to areas with the strongest returns. We're managing costs tightly, and we expect at least \$37 billion of net interest income next year. As rates normalise, we're simplifying and digitising the bank. We are engaging and will continue to engage with all our shareholders. We share their desire for improved returns and understand the importance of dividends to them. We think the best and safest way to improve returns is to focus on our strategy, which we are confident will deliver a return on tangible equity of at least 12% from 2023 and materially increased distributions.

With that, can we please open up for questions?

RICHARD O'CONNOR, GLOBAL HEAD OF INVESTOR RELATIONS: We'll take most of the questions from the audio lines today. We have a few analysts and investors in Hong Kong who – after four or five from the lines, I'll see if anybody raises their hands, and we've got a microphone to come around and hopefully get some questions from Hong Kong.

RAUL SINHA, JP MORGAN: Good morning, everybody. I've got two, one on capital and one on strategy, please. On capital, when we look at the second half of the year, you've got, it looks like, a step up in CTA, and, obviously, the impact of France / M&A - It looks like second half may be less capital generative. I'm just wondering if you could talk about the moving parts or the actions you could take to build the capital ratio back up to 14%. And related to that, when do you think you might be in a position to buy back stock again from a capita] perspective?

And then the second one – strategy - just going back to structural change slide and the analysis there, I guess the main interesting point here is the ongoing cost of running two separate groups within a different structure. I was wondering if you might be able to share a little bit more colour in terms of what is the magnitude of additional cost that you see if you were to pursue structural change, just to give us some sense of the materiality of these costs – some of your points on the slide look like they could add up to quite significant costs. Thank you.

NOEL QUINN: Thank you. I'll ask Ewen to take both of those questions, deal with capital first and then your questions around costs of executing alternative strategies.

EWEN STEVENSON: Raul, the line wasn't perfectly clear, so I'll do my best. On capital, I think the first part of it was understanding the moving parts on the rebuild of capital. From first half, the 13.6%, obviously we've given you the M&A impacts that we expect in Q3. In addition to that, we are taking probably about 20 to 30 basis points of incremental capital actions that we previously haven't talked about with the market, which you should expect to come through in the second half of this year. We also remember that under the Bank of England/PRA rules we have to accrue dividends at the top end of our 40% to 55% pay-out ratio.

So in the first half effectively the common equity tier 1 ratio is understated because of that accrual. And there's a catch-up that you'll see in Q4, so we do think that we'll trough next quarter a bit below where we are. We'll be back close to 14% by full year. We'll be back within range 14 to 14.5% during the first half of next year. And then your question on buybacks then links into that, which is you should not expect us to be doing buybacks until we're back within our common equity tier 1 range of 14 to 14.5%, which, you can imply from that will be more back-end loaded next year as a result.

NOEL QUINN: Thank you. Just before I get to the detail or go to the specific that you asked, just on the alternative structural options I think what you've got to take into account is there is a combination of impacts. There is a negative impact on the revenue synergies that we have identified in the paper. There's a negative impact on some of the funding and capital synergies that exist in a group that's well diversified. There's a negative impact on the costs of executing, which are one-off costs, and then there are some ongoing cost impacts in terms of the funding costs of a less diversified group, split into two, would be higher than the funding cost of a diversified group. And then there's some ongoing running costs that you'd incur.

I think it's the totality of that that you've got to look at, not any one item, and there are many judgment calls to make in that equation, but whatever way you balance those judgment calls, we believe that the safest and fastest route to generating increased dividends and increased returns is the strategy that we're pursuing. We've given you schedules in the pack and in the appendix to help you understand some of the factors that need to be considered, so I don't think there's any one cost item that I think is more relevant than the other, but it's the package, and then you've got high execution risk because something of that complex nature can take three to five years with uncertain outcome for regulatory approval and for investor approval.

EWEN STEVENSON: Yeah, just to give a bit more colour around some of the numbers, Raul, as Noel said, if you just look at the one-off costs associated with setting up a structure, if you were to have a separately listed Asian subsidiary you would have to be able to demonstrate that you had standalone IT systems, which would probably take three to five years to construct and would run probably into the billions of dollars to be able to do that. You have a \$40 billion MREL stack currently sitting in our Asian subsidiary, all of which is downstreamed from the parent. Again, there would be a three-to-five-year issuance programme required to reissue all

of that MREL out to the public markets and effectively do a liability management exercise on that excess MREL that was sitting at the group.

You would have potential tax impacts because of triggering capital gains tax implications as you did the restructuring, and other one-off costs associated with effectively recreating a standalone business here - here being Hong Kong, where I am today. And then you go into the ongoing de-synergies. For example, in the slides we've showed you that of the \$20 billion of wholesale revenues, 45% of them relate to international customers, so you can run your own maths on what portion of that \$9 billion would be at risk, but it wouldn't be immaterial. You would have to effectively duplicate corporate functions and IT run costs that we get global synergies on today. We would lose group purchasing power benefits that we get today. We think you would have to operate our Asian business at a higher common equity tier 1 ratio as a standalone business because it wouldn't benefit from the group support that it gets today that the HKMA does take into account.

There's about \$100 billion of AT1, tier 1, tier 2 capital sitting in the rest of the group. We think if you were to break out the Asian subsidiary there's a significant risk that the rest of the group would de-rate from a ratings perspective. A one notch downgrade on that \$100 billion we think is a 25 to 50 basis point impact per annum. Our UK business holding company today has a number of tax benefits. The UK has far better withholding tax arrangements with the rest of the world compared to Hong Kong, and we also get a tax shield on our UK headquarters costs in the UK.

And then you go into the complexity of execution. All of the timelines point to three to five years. In that three to five years we would have to prioritise IT change in respect of the separation rather than IT change in respect of the core business. We need regulatory approval in about 25 jurisdictions. There would be questions around indexation. We're currently fully indexed in both markets. US dollar clearing we don't think would be available to the Asian subsidiary, and we don't think that we would readily be able to get a dollar clearing license for the Asian subsidiary, as we've seen with others. As Noel says, when you package all of that up in terms of cost to implement, complexity to implement and ongoing de-synergies, we just really struggle to come up with any form of value case that we could put in front of shareholders.

MANUS COSTELLO, AUTONOMOUS: Thank you very much for the long list of negatives with regards to the breakup costs. I wondered if, in the spirit of putting all of the considerations in the public domain, you could discuss, on the other side of the ledger, the upsides, potentially, of a breakup. Do you think it's possible that you could see faster growth in Asian entities? ? Do you think that there could be a better valuation attached to them? Can you just explain your considerations on both sides of the argument?

NOEL QUINN: We're already seeing strong growth from the execution of the current strategy. We're already very focused on the growth opportunities in Asia. You can see that in Hong Kong. Our Commercial Banking business has had very strong growth here in Hong Kong, and globally trade business is up 20% in revenue. To be honest, Manus, we've already factored in strong growth opportunities in Asia, and we're deploying more and more capital into Asia. For us, we've already got that growth scenario factored into the current plan. And then your second point was...?

EWEN STEVENSON: Around re-rating.

MANUS COSTELLO: And valuations.

EWEN STEVENSON: Could you imagine a different business plan for Asia? Yes, you could, Manus, but you would have to work through all of the capital funding, liquidity implications and risk appetite implications of that. There's been some suggestions that we could accelerate growth in some areas, but that would come with a change risk appetite and therefore change capital funding and liquidity implications that we've started to work through, but again, we think the overall net de-synergies outweigh any of those positive synergies.

Yes, you could speculate that there could be a re-rating of the Asian business if it was separated out it. Equally, we think there would be a de-rating of the rest of the world, so when we've looked at those two together, we haven't been able to convince ourselves that there's some kind of magic structural alternative that delivers a re-rating for the overall group.

OMAR KEENAN, CREDIT SUISSE: Thank you for taking the questions. Congratulations on a good set of numbers. It's good to see jaws coming through so strongly.

I've got two questions, please. So my first question is on the analysis of the strategic options, and I wanted to ask you, is there anything that you've decided to do that is incremental to the strategy because of the process that you've gone through during the past couple of months? What I can see is that cost efficiencies have moved to the upper end of the range, and you're talking about 20 to 30 basis points of additional capital actions. I was hoping you could add a little bit more colour specifically on those two points and anything that we can't see in how your thinking's evolved.

My second question is on deposit beta. One of your peers said last week that we were starting to see some migration from current and savings accounts to time deposits. I was hoping you could give us some updates on how you're thinking about the competitive environment and deposits as we look forward.

NOEL QUINN: On your first point I'll just answer that, and I'll pass to Ewen for the second point. We're very determined to improve the performance of the business. We take all feedback that says the business hasn't performed well over the past 10 years - we take that to heart - and have done, and are very committed to trying to drive our capital efficiency into the business. We constantly look at parts of the portfolio that are strategically less important and are underperforming, and we're determined to continue to drive out efficiency into the capital allocation of the business.

On the specific point of the additional capital management actions we're taking, I think that's in response to the CET1 impact of the mark-to-market on the treasury book. That's in addition to mitigate the downturn in the CET1 as a consequence of that, but we're confident that the capital build coming from higher profitability will start to reboot the CET1 towards the end of this year and into next year. But those capital management actions are not in response to structural considerations, they're more in response to near-term capital management activities. Those actions are tactically important and the right thing to do, but they're not strategically damaging to the franchise of the bank. We're not having to turn off good, strategic growth. We're able to take those actions whilst pursuing our strategy.

EWEN STEVENSON: What you can see in the results today is an attempt by us to be clearer on what the strategy is, giving you more disclosure around the international connectivity of the business, clarifying what we thought was a significant gap to our internal views on dividend potential for 2023 and beyond, versus where consensus was. What we've tried to do is, if you want, clarify the strategy a lot clearer that we're pursuing.

On deposit betas, we are seeing currently very little migration to time deposits so far. Remember that a significant part of our book is actually not time deposits, but I think if you look at previous cycles you would expect migration to occur as interest rates continue to rise. As we've said previously, the modelling that we've done in the interest rate sensitivity is based on a 50% pass-through rate. We're well below that at the moment. We do think it will rise from here, and part of the reason it will rise is because of migration.

AMAN RAKKAR, BARCLAYS: Good morning and good afternoon, Noel, Ewen and Richard. Two questions, if I may. Firstly, on your net interest income guidance, thank you so much for giving us the greater than \$37 billion. I note the rate assumptions that you're making behind that are laid out on slide 18, i.e. in line with market implied policy rates. I guess there's a pretty healthy debate amongst investors when I speak to them as to whether we actually get to those level of interest rates and, if they need to get cut again, maybe if growth were to weaken. I'm interested in your thoughts around to what extent, if the full rate didn't appear as part of the forward curve at the moment, what risk would that pose to your ROTE ambitions? Do you have levers that you can pull? Is that \$37 billion NII guide at risk if you didn't quite get to an at best circa 3% base rate, for example?

The second question is just around capital. I note the actions that you're taking to lift the CET1 ratio back towards target range, but that actual target level – how are you thinking about that? When I compare that to your MDA, there's a pretty handsome gap of around 300 basis points

towards your target level. That feels quite large. Is there anything that you can do or you're hoping for from the regulator to try and get that target level down?

EWEN STEVENSON: On the NII guidance, a couple of things. You should assume that we've got a bit of fat in there when we're guiding to at least \$37 billion. Secondly, remember that as interest rates continue to rise, deposit betas will continue to rise. So if you don't get that final edge on interest rates at the back end then – we're already modelling very high deposit betas at that time, so the implicit impact on the net interest income is a lot lower than what you may think. We've run various scenarios and are comfortable, based on a range of scenarios at the moment, that we'll be able to deliver \$37 billion, but, obviously, if there's a very material change in rates, we'll reassess that. We've given you the interest rate sensitivity so you can run your own numbers.

On capital, there is a debate at the back end of 2023 and 2024 on whether we can adjust common equity tier 1 ratio. If you think about where we've been in the past, we've been making a very big investment internally into our stress testing capabilities, into our recovery and resolution capabilities, which you don't see from the outside. We also didn't have the returns in the past, the combination of the returns that we had and a very high pay-out ratio that we had in the past. We just didn't have the same capital flexibility that we'd expect to have from 2023 onwards. I think it's important before we engage the regulators in that discussion that we get back within the range, but I think once we're back in the range there should be some model stability to adjust down where we're targeting on common equity tier 1, but I would say that's back end of 2023, 2024 for discussion.

GURPREET SINGH SAHI, GOLDMAN SACHS: Congratulations on a good set of numbers. I have two quick questions, please. The first is on the Prime Rate in Hong Kong, and then the mortgage cap that should effectively be hitting all the mortgage borrowers starting next month, if I'm not mistaken. What could be the efforts to narrow that "Prime-minus", and hence to lift the effective gap for the mortgage borrowers? How much of that can we do before we see deposit migration, as Ewen, you have talked about, and then we run into that question of raising the Prime interest rates. Once they are raised, will it be symmetrical with the savings deposit rate or asymmetrical? That's the first question. Sorry for being a lengthy one on this one.

The second is simple, on the credit cost. So as of now I see China here is still contributing nearly 30% of the total provisions. At some point during this year or early next year it's going to roll off. We aren't going to book CRE losses until eternity, right? I still see the guidance on the second half of 40 basis points versus first half 20. How much of the typical hallmark HSBC conservatism goes into that?

NOEL QUINN: I'll take that as a compliment, 'traditional HSBC conservatism'. I think that's something good to be accused of. Let me deal with the China CRE and then I'll ask Ewen to deal with the Prime Rate and the mortgage cap. The ECL charge in the first six months is a positive outcome, but the economy's still uncertain, so I think it would be unwise of us at the half-year stage to start factoring in the first half performance as a trend for the full year, and therefore it is appropriate to guide to a higher second half charge, given the level of uncertainty.

I think we'll update in Q3, and, clearly, we'll know the answer at Q4, but it would be unwise to think that the first half trend is something that can roll forward into the second half. Our expectation at the moment is that forward economic guidance will probably continue to worsen, and therefore there's more likely to be stage 1 and stage 2 provisions in the second half of the year rather than necessarily us having a line of sight to stage 3. That build of ECL in the second half is going to be more around stage 1 and stage 2 as economic forecasts continue to deteriorate and forward economic guidance is factored in. That would be the view on the ECL, but happy to be conservative at this stage. Ewen, do you want to cover Prime Rate?

EWEN STEVENSON: Are you sure you don't want to cover that, Noel? Just to add on ECLs, we haven't said they're going to be 40 in the second half. We said that they're trending towards a yearly average of 30, so that would be the highest we would expect them to be in the second half.

On the Prime Rate, not for everyone in the room here in Hong Kong, who understands this, but for everyone who's not in Hong Kong, the mortgage market here is typically priced off one month HIBOR plus a spread. The borrowers also have an option to shift from that rate to what's

called the Best Lending Rate minus a margin. Today those two rates are broadly in line with each other, maybe even – I would say most of our mortgage book is tipping into the latter, i.e. the Best Lending Rate minus a margin provides a lower rate to customers than one month HIBOR plus the spread we're charging them. That rate is set daily and calculated daily and the customer doesn't need to do anything, it just happens automatically that they switch from one rate to the other.

Today, about 12% of our portfolio is subject to the mortgage cap, but I would say that given movement in the last month or so that's likely to trend materially higher, to most of the portfolio, over the next couple of months. I'm clearly not going to sit here and give guidance on what we're going to do with the Best Lending Rate. Historically going back – I think for 20 years – the Best Lending Rate has moved in line with the best savings rate, so we have seen slightly lower margins in the past, discounts being applied to the base lending rate. That's obviously one tool we have. If we were to change the best lending rate and the best savings rate followed in tandem, that would be economically worse for us, given that we have a larger deposit surplus and would see a bigger hit on higher savings rates than the benefit we would get from raising the lending rate. But clearly this is all subject to competition, and we're not going to discuss it on a public call.

ANDREW COOMBS, CITI: Two questions, please. The first is just to clarify the \$31 billion and \$37 billion net interest income guidance that you give. Could you just provide a bit more detail on what you are assuming on deposit betas – because I know you have illustrative numbers on 50% but in your commentary, you talked about the deposit beta rising as you go through the rate-hike cycle. It would be good to just clarify what beta is assumed against that \$31 and \$37 billion.

And my second question is just the disconnect between average interest-earning assets and loan growth. If you look at the quarter on a constant currency basis, loans are up 1%, average interest-earning assets are down 1%, so that's giving a disconnect. Given your guidance for next year for mid-single-digit loan growth, do you think the average interest-earning assets will reconnect with the loan growth next year? Thank you.

EWEN STEVENSON: On the second one, Andy, average interest-earning assets are not FX adjusted. If you talk to our research team afterwards, they'll be able to give you a FX-adjusted average interest earning assets.

RICHARD O'CONNOR: Also, some lower liquidity balances in the quarter as well.

EWEN STEVENSON: On NII guidance, you know I hate giving NII guidance, so I thought I was doing well today to give it. We're not going to go in and give you deposit beta assumptions as part of that. We've said through the cycle we expect it to be 50 per cent. We've said that deposit betas so far have been in the 20s. You should assume that there's a material ramp up in deposit betas as rates go higher from here.

ANDREW COOMBS: Okay, and on next year you think the average interest earning assets should be more aligned with lending.

EWEN STEVENSON: Yes.

MARTIN LEITGEB, GOLDMAN SACHS: Good morning. First of all, let me echo the comments on the good set of numbers today. I was wondering, two questions on structural hedging. I was just wondering if your appetite has changed towards deployment of some structural hedging or maturity transformation, or however one wants to call it, in geographies outside of the UK in order to move or transform some of the deposits into more medium term maturities and to stabilise the NII going forward. Can you just update us on where you are with structural hedging?

Secondly, you called out the standout performance of the UK. I was just wondering if you could provide a little bit more colour on what is precisely driving that strength?

EWEN STEVENSON: On structural hedging, firstly the nature of our book here in Hong Kong where it's difficult to extend – if not impossible to extend – the duration, given the nature of the deposit base and the asset base here, we can't buy longevity in Hong Kong dollars. Secondly,

on the asset side, the trade book is very short dated too. We do typically have more interest rate sensitivity than most of our peers.

Having said that, relative to what we could do, we are structurally under-hedged. We have, for example, started to – as some of the hold-to-collect and sell portfolio is beginning to mature, we've materially increased the hold-to-collect portfolio during the quarter, and you should expect that to continue. I think we will slowly increase the level of structural hedging overall in the bank over time to reduce some of the interest rate sensitivity, but, given the nature of the balance sheet, I think you should assume that we will continue to have higher interest rate sensitivity than peers even after we've done that.

On the outperformance of the UK business, which I think was the second question, I just think Ian Stuart and team are doing a really, really good job at the moment. They're taking very assertive actions against their cost structure. I think costs were down 8% Q2 on Q2. We've always told you that we're structurally underweight in some segments like mortgages. We had 7% mortgage growth year-on-year in Q2. The Commercial business is going well at the moment in the UK. Post-Brexit we are the only bank in the UK of any size that can really deliver an international network to customers, and, as customers change the nature of their international businesses, we're ideally placed to service that. Obviously, credit conditions in the UK, at least for us, continue to remain relatively benign.

NOEL QUINN: Another statistic on the UK. Year-to-date the UK business has helped more than 1,000 overseas customers purchase or refinance properties in the UK in the first six months of this year. And then on the other side of the equation I'm really pleased to say that the UK business has offered great support – they've helped more than 5,000 Ukrainian refugees to the UK open a bank account with us, so I think what you're looking at is a broad base of activity in the digital world.

The UK has now onboarded 40,000 clients onto HSBC Kinetic, which is a fully mobile digital proposition for SMEs. The full range of product suite there, not just account opening, but cards, lending, overdraft, savings accounts. 85% of those customers have been onboarded within 48 hours and the customer satisfaction is currently sitting at 92%. You've got a broad base of actions that Ian and the team have taken in the UK: cost, revenue generation, product enhancements, digitisation, the international clients and the domestic clients. I think there's a lot of good work being done there, and it's starting to pay dividends.

GUY STEBBINGS, BNP PARIBAS: The first one is just on capital actions and if you can elaborate on what you're doing in – I think it was the 20, 30 basis points of planned actions in the second half of those and any revenue hits they might have. What informs taking those actions now? Would it not have been possible just to build the capital naturally and get back to target a little bit more slowly, especially given the capital hit is in part rate-driven, which is P&L beneficial and in time, ultimately, net positive?

The second question - thanks for all the colour and all the guidance - it's very, very useful - I just wondered, given where the market-implied rates path is now, were that to shift any further up, would you still see that as net beneficial to the bottom line, given deposit mix, etc? I just wondered how much incrementally benefit you would still see if rate rises went even further than the market-implied path. Thank you.

EWEN STEVENSON: On capital actions, they mainly benefit RWAs. It will have some, but modest, impact on the P&L, but when we think about the balance of considerations of heading into probably tougher economic conditions in 2023, the right thing for us to do is to accelerate our capital ratios to being back within target. So we're happy to accept some impact on income in order to achieve that, but we do think that the return analysis that we're running on those incremental actions make sense, and we're not doing anything that goes into what I'd describe as franchise impairing actions.

On NII, I think it is market dependent. So, here in Hong Kong, there's probably very little benefit that we would derive from interest rates going higher than what's implied in forward curves at the moment, but I think, in other markets, definitely there would be value. And I still think that we're structurally geared. If you think about the last couple of years, in 2021, net interest income was slightly under \$27 billion. So over two years we're generating an extra \$10 billion of net interest income which more than offsets any incremental ECL costs we could see or higher

costs because of inflationary issues. So I still think there's some way to run, even based on forward curves, before you start seeing impairments materially tick up.

I think the other thing that's important to remember, Guy, for us, and it probably applies to other banks, but our customer base on the retail side is mainly affluent. They've had their savings rates go up materially during Covid. So they're all sitting quite liquid with good cash reserves at the moment. We've seen credit card spending pick up, but people are still mainly rolling their credit card balances, so we don't have any particular difficult credit exposure on the retail side that I would call out, with the customers sitting with good cash balances.

And now, on the mainstream corporate side, the global corporate sector has effectively been de-leveraging for two and a half years. In most parts of the world, corporate loan growth has been well below nominal GDP growth. So, again, corporate balance sheets are unusually healthy for what would be at this point in a cycle facing a downturn. So for all those reasons, I think if interest rates went higher, other than Hong Kong, I think we would view that as a positive for us.

RICHARD O'CONNOR: I think we have time for one more question, and then we'll hand back to Noel to sum up.

TOM RAYNER, NUMIS: Thank you. Hi, everyone. Since you're feeling so charitable and you're giving specific guidance on net interest income, costs, returns, I could possibly back out what you're thinking on non-interest income, but I just wondered if you could give us any colour on what you're thinking in terms of the main drivers: Covid restrictions, trade, what's going on in capital markets, Chinese GDP, all of those things to look at. But seems to be a missing piece of the P&L that we don't have now.

NOEL QUINN: Tom, you know how much Ewen likes giving guidance on NII. Now, you're asking him to give guidance on NFI as well.

EWEN STEVENSON: Tom, if my chief accountant was here, we'd be running dangerously close to giving a profit forecast. But the only thing I would say is, when you run your calculations for 2023, do you think about all of the one-offs that we've had this year, including the negative insurance MCU that won't repeat, or shouldn't repeat next year? But I'm not going to give you a non-NII forecast, but nice try.

TOM RAYNER: Okay. Perhaps I can just comment on the trends. Covid and other stuff. Any thoughts on just more broadly?

NOEL QUINN: What we've all got to factor into our future thinking is – take here, in Hong Kong. There should be, at some point, a rebound in wealth management activity that will drive higher fee income. There should be, at some stage, a rebound in capital market activity that should drive higher fees for GBM, but it's too early at the moment to predict exactly how much of that will come back and when it will come back. But you could argue, if you look at the P&L of WPB for the first six months, they've got revenue growth, and what you've found is that the retail banking has driven strong growth from NII, but has been subdued on its fee income.

And then, if you can start to get the fee income coming back as economies reboot and wealth management activity re-establishes itself, then you should start to see a growth in non-interest income, but it's too early to predict what that will be, and we're not going to give guidance on it.

TOM RAYNER: Alright. Thanks for that.

NOEL QUINN: Thank you. Well, thank you very much for all of your questions and for giving us your time. To close with a few comments, we are confident of significantly improved value for our shareholders. Our repositioning of the business is gaining traction. Our international connectivity remains our greatest strength. We have got costs under control, and interest rates are normalising. All of this means we are on track for our best financial performance in a decade, 12% returns-plus in 2023, and higher dividends for our shareholders.

Richard and the team are available to you if you have any further questions, but, in the meantime, have a good afternoon or morning, and thank you very much for joining us.