Edited Transcript

Q1 2017 Post-Earnings Release

Meeting with Sell-Side Analysts hosted by Iain Mackay, Group Finance Director

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Corporate participants:
Iain Mackay, Group Finance Director
Richard O'Connor, Group Head of Investor Relations
Hugh Pye, Head of Investor Relations, Asia
Kathleen Gan, Chief Financial Officer, Asia

HSBC

Iain Mackay, Group Finance Director

Welcome to first quarter results analyst meeting. You've had a chance to go through the numbers and the various releases, so I'll just go straight to questions.

Alastair Ryan, Bank of America Merrill Lynch

Can I ask about Europe? So on an adjusted basis in Q1, it's about 11% of Group profits, 37% of Group loans and advances. What's the underlying issue in Europe? It seems to us that UK profits industry-wide are probably more or less at a peak. Certainly the funding advantage you traditionally have has been eaten away by central bank subsidies elsewhere, so there's a lot of margin pressure in the UK. The underlying cost income's very high in Europe. A point well taken that there's Group cost in there, although some of those are now in corporate centre, but really how do you get Europe to make more money, ignoring the one-offs, and what's the drive there?

And second part of the same question, in the light of some quite weak underwriting standards of your competitors in your largest European market, the UK, which suggests that chasing volume growth might not be consistent with HSBC's over-the-cycle risk appetite, and what are those areas?

Iain Mackay

So in terms of direction of travel around an analysis and disclosure in Europe, one of the things we are going to work towards is getting to a clean view of the ring-fenced bank, obviously, because the ring-fenced bank will go into operation in 2018 and become a live factor, obviously, by law from 1 January 2019. And then by – almost by definition – get to a clean view of the non-ring-fenced bank, which, for all intents and purposes, will be Global Banking and Markets in the UK, the corporate centre, and any costs that sit in Europe that are outside the corporate centre and then, obviously, get to continental European profitability, so whether it's the French entity, the German entity and provide an appropriate level of disclosure.

But within the UK I think it's important that we get to, dare I call it, a clean operational view of the ring-fenced bank, the non-ring-fenced bank and then headquarters corporate centre, per se, and that's something that we're working on now.

In terms of when you then look at the operating profit, we still – particularly this is true within Global Banking and Markets and, to a slightly lesser extent, within Retail Banking and Wealth Management and Commercial Banking. There's a lot of the risk management and the corporate leadership – if you like, the Group leadership of those three businesses sits geographically in Europe. So although it is obviously recharged out to the different entities in line with an allocation key and in line with, particularly from a management perspective, anything we do by legal entity is very much guided by OECD guidance around how you do intercompany billing. But there is a concentration of the leadership of those businesses that sits within the European region and, again, that weighs more heavily on the costs of Europe as the report within the disclosures that we provide to you at each quarter.

I think one of the things that, whether forced by ring-fencing or whether forced by Brexit, we are going to have to get – if not just better disclosure, we are going to have to re-examine the basis on which costs are allocated to the different global businesses and operating regions within the Group.

In terms of how we grow the business, in the UK – this is what we'll migrate to – the UK ring-fenced bank, on a pro-forma basis, provides good returns. It's basically Retail Banking and Wealth Management, Commercial Banking and Private Bank. And those businesses generate good returns and on a pro forma basis you're talking about returns on equity which are well above the cost of equity at this point in time on a clean basis.

To grow those businesses, you'll recall that we talked about an appetite to continue to grow mortgages within the UK. We're sitting just over 7% of UK mortgage market share. We are keen to grow that but we're keen to grow that with the customer set that we've got. So the average LTV – the LTV on that portfolio in the UK is in the low 40s. Origination today of new product within that portfolio is in the low 60s.

You may have seen advertised in the UK a new five-year fixed rate product we put out at 1.69% with a £999 booking fee but to get that you had to have a 40% down payment.

So, again, the kind of customer that we are focused on is a customer that represents a more resilient household, in effect. The same is true from an unsecured perspective. You look at the balance – outside Hong Kong, you look at the balance of the Retail Banking and Wealth Management and it's dominated by current accounts, deposit accounts, and mortgages, right? And there is a need to get a better balance between secured and unsecured but, again, when you look at unsecured, it's building a book of business with the Premier and the Advance offering which represents a more resilient household.

Now, that is a more difficult business to build because it tends to be the type of household that doesn't necessarily need a greater deal of unsecured, except in the credit card space. So, again, to build the credit card business in the appropriate manner in the UK – not only in the UK but also in France – is something that John and the team are keen to do.

We're very much focused on growing the European business and what you saw in the first quarter was Commercial Banking maintaining momentum around building balances and growing the income, largely driven by Global Liquidity and Cash Management, but good balance build, both in Global Trade and Receivable Finance and in Credit and Lending, although some spread compression on the asset side in that space.

And then you obviously saw in the first quarter Global Banking and Markets with very good revenue generation, particularly through Rates and Credit. More to do in Global Banking in that regard. And then across each of the businesses – well, I won't exempt them completely but Commercial Banking is further ahead than the other two in terms of continuing to improve the cost efficiency ratio within Europe.

So it's a continuum that's ongoing, Alastair, but I have to confess there's more we need to do to give a clearer view to all of you as to exactly what the underlying adjusted performance of each of those businesses are within Europe. But that's where we are from a focus growth perspective and cost management standpoint.

Tom Rayner, Exane BNP Paribas

Can I just ask you on the margin in the first quarter, up four basis points? It looks like it was completely driven by a decline in average interest earning assets; net interest income went slightly down in the quarter. When I try and look at the sort of split out of what happened in there, it looks like loans were up. Non-loan average interest earning assets therefore must have been down something like $30 billion in the quarter.

I just wondered if you could comment on what's going on there and give a bit more colour. How much should we look at the quarterly trend on margin because it seems like some of these items may be volatile or move around for liquidity reasons. I just want to understand that first-quarter trend a little bit better, please, if I can.

Iain Mackay

Yes. I think in terms of reduction around average income earning assets, there will be a little bit of volatility around that. You tend to be looking at – when the cash balances were down, some financial investment balances were down and lower reverse repos. In total, we would add that up to about $26 billion, $27 billion of reduction. Now when you look at what that represents, particularly when you look at reverse repo, which tends to be a bit volatile, but frankly that was a smaller element of the component that we were dealing with in the first quarter and then cash and financial investments. A good deal of that tends to be positioned around how Balance Sheet Management are setting themselves up.

The other component that we did see beginning to come through in the first quarter with some expansion and liability management, not asset margin but in liability margin. And we saw that beginning to come through in Hong Kong – anything, basically, that was US dollars started to show, as you would expect, some benefits coming through.

That was largely – not entirely – but largely offset by the continued impact of the bank rate reduction in the UK in the middle of last year. I think we hit a normalised point from a comparison perspective in third quarter of this year, but your analysis is correct. The degree to which there is going to be real volatility around those average income earnings assets is going to be largely driven – not uniquely – but largely driven by those three factors that we represent, some of which is driven by customer business; some of it is how we position around Balance Sheet Management.

Tom Rayner

The red-inked balances – in your presentation you do try to help us with that. I was just trying to get a sense of what the real constant currency underlying loan growth was in the first quarter. It looked about 1%, i.e. 4% annualized. Is that correct, and if it is, is that a sort of pace of growth you think you can continue through this year?

Iain Mackay

Yes, if you look at the gross movements, if you take out the red-inked components, we grew loans and advances by about $15 billion in the first quarter, but there was a netting effect of about $6 billion in terms of those red-inked balances, so netting between overdrafts and customer accounts.

Richard O'Connor, Group Head of Investor Relations

And in that, then, the run-off CML, so if you took out CML, it was $9 billion Q117 and about $35 billion underlying year on year, which is just over 4%, or just over 1% in the quarter. So that's in the appendix slide.

Tom Rayner

Is that a sustainable kind of growth rate, do you think?

Iain Mackay

Again, going back to what we talked about at the end of the year, we expect loan growth over the course of 2017 to be somewhere in the 3-4% range and then, off that, rebased revenue, taking into account the full effect of foreign exchange, something similar in terms of revenue line.

Richard O'Connor

I wouldn't personally – we had 14% year on year growth in Hong Kong, 3% in quarter and Asia 10% year on year, there's a bit of restocking in Q1 as you saw in the region. I think you'll still see good growth in the year, but I wouldn't annualise.

Raul Sinha

Just maybe if we can stay on the topic, I just want to phrase my question in two ways, firstly to try and understand your comments about the buyback and the fact that you decided to pause it for a while. Is that more driven by the cash flows in terms of what capital is trapped in the US versus the free cash available, or is that actually a subtle change in the tone that you want to reposition the Group towards more growth?

Iain Mackay

No change in tone. Going back to I think it's the second last page in the investor deck – and Stuart has been very clear and to the extent of possibly even being repetitive or boring on this topic, our priority is to look for opportunities to invest capital in the growth of the firm; that growth – that profitable growth that delivers against the returns, because the whole risk-weighted asset thing was about taking unprofitable capital out of circulation and making it available for allocation to profitable lines of business and profitable customer relationships.

And that is the first priority because that then obviously creates the profitability that supports and hopefully creates the opportunity not only to sustain the dividend but build the dividend, but also for us in terms of cash flow coming up from the subsidiaries, which – it's good to get surplus capital out but you go beyond getting the surplus capital out, you want that cash flow coming from the subsidiaries, not only to support the dividend but also to support – over the longer term, deal with some of the dilution that comes through the scrip.

We still have work to do to find an appropriate replacement for scrip for the Hong Kong investor base. That's an important part of our investor base; it's more than 25%. The scrip is viewed, for whatever reasons, it's viewed very positively in Hong Kong and until we come up with an appropriate alternative for that, I think it's unlikely that we'll see the scrip disappear in the short term. And therefore what we'd like to be able to deal with over time is the dilution that those shares represent – the scrip represents.

And one of the ways to deal with that is to obviously ensure that we've got robust cash flow coming from the subsidiaries, which means investing in those subsidiaries to generate profits, to upstream it in terms of dividends: one to support the dividend and, over time, hopefully to grow it, but also to use part of that flow up from the subsidiaries to support buybacks, which will clearly help deal with some of the dilution issues.

So if you like there are several phases in this. One is getting the subsidiaries to be capitalised at the regulatory minimum plus a small buffer and anything above that small buffer that deals with natural volatility or uncertainty within the business environment is to get those surpluses back to the holding company group in the UK, which is largely what the US is all about, along with two or three other legal entities within the group.

But once we've done that, it puts us in a position to invest in the group, consider buybacks from time to time as we think appropriate, but in the longer term, the idea is that you would exhaust that capital, either by investing it or returning it to shareholders. But going beyond that, you're still going to have to create that cash flow dynamic from the subsidiaries that can deal with supporting a dividend and potentially having to deal with resolution issues.

Raul Sinha

But I mean, if we just stay on that topic, clearly you've got – I think you've done \$280 billion of RWA reduction and your original target was \$180 billion to –

Iain Mackay

No, the original target for reduction was \$290 billion and, FX adjusted, it was \$277 billion, I think.

Raul Sinha

But in terms of the reinvestment of that, if you look at the net impact on the group, the reinvestment I think has only been about \$70 billion.

Iain Mackay

That's about \$70 or \$80 billion, yes.

Raul Sinha

So there's a lot of free cash that's been generating by the very correct actions that you took previously, and I guess the question that I'm trying to ask is: is there more potential to deploy that through loan growth, which we can see coming through a little bit?

Iain Mackay

Yes.

Raul Sinha

But are you also starting to now think about acquisitions and is that one of the reasons why you might want to pause some of the capital return expectations in the market, because acquisitions might actually be a better way of giving you –

Iain Mackay

So I think acquisitions are – they're less off the book than they were, but again they've been very focused. So one of the things that Stuart had talked about previously was looking at our Asset Management business. Asset Management is relatively low in capital intensity in terms of operational day-to-day. Again, the breadth of the network should position us to be able to bring insights and develop product that is highly attractive to an investing community, and there is more that we can believe we can do with our Asset Management business.

There is an aspect of also putting our Asset Management business in the position to be able to deal with that, but if we were to deploy capital inorganically in the short term, I would suggest it's probably to be in an area which is going to be low in capital intensity and, from an integration perspective, particularly from a customer due diligence standpoint, is easier to do.

Manus Costello, Autonomous Research

I have a question around MREL and loss-absorbing capacity, please. I see you got the Bank of England to accept the MPE (Multiple point entry) status on Friday. I think that came out finally in print. My understanding, if I'm correct, is that HSBC Bank Plc will be bound by MREL but the other entities will be bound by local loss-absorbing regimes. And I wondered if you could update us on – I think we understand how MREL will work for Bank Plc – but can you update us on what you expect, primarily I guess, in Hong Kong and the US, and what the risks are to thinking about your potential loss-absorbing requirements.

Iain Mackay

Yes, so at the moment, the only other jurisdiction that has provided substantive guidance on TLAC is the US. There is – guys at the back, correct me if I'm wrong, but I don't think there is any other jurisdiction that presently has provided substantive guidance on MREL / TLAC. So you've got good guidance around the UK and I think the disclosures from the Bank of England on Friday were very clear about what we would be bound by with respect to the UK and on the basis of multiple point of entry.

And, to be clear, from a group perspective we understand the guidance will be bound by the greater of, either – and we'll use 1 January 2019 dates for ease of discussion – 16%, 6% leverage exposure or, the higher of the combination of the multiple points of entry resolution regulators.

That is helpful for the UK environment, somewhat helpful in the US environment but still leaves a question unanswered with respect to the Group as a whole, if you only took the major resolution hubs within the group, which are the US, Europe (so HBEU or Bank Plc and its subsidiaries) and HBAP Asia, (the bank in Hong Kong and its subsidiaries), if those are the three main resolution hubs then the guidance that we require would be from HKMA. We could get guidance from the Monetary Authority of Singapore, from APRA in Australia, from Mexico, from Canada. So there's still quite a lot that's at play in that space.

Clearly, where we're approaching this from is ensuring from a multiple point of entry, when you add all of that up it shouldn't be more than 16% of risk-weighted assets or 6% leverage exposure. There should be – there's no guarantee there is, but there should be advantages to being a multiple point of entry resolution organisation for a whole host of reasons within the prudential regulatory construct. We've got to try and ensure that there are.

Chirantan Barua, Bernstein

Lots of speculation around the $1 trillion number, which is the cash held by US corporates outside of the US; once the tax laws come into effect, the thesis is a trillion goes back to the US. You're a broad transaction bank. My question would be: have you looked at how much of your cash book could be subject to this whole repatriation whenever it comes in the next one to one and a half years?

Iain Mackay

That's an interesting question. In terms of our customers?

Chirantan Barua

Correct. So if you take the thesis, there's $1 trillion of cash somewhere in the banking system outside the US, and that cash in the next one and a half years, if Trump gets it right, is going to go back to the US. That means, in terms of a funding basis, the rest of the banking system outside the US will be devoid of $1 trillion. It's a big number and it'll likely be concentrated, because of big US institutions.

Iain Mackay

That's on the banking system or with our corporates? Because, if you look at it again, our predominance is corporate customers. Yes, we've clearly got a FIG customer base; yes, we've got broad-based relationships with banks of all different sizes around the world around corresponding banking, supporting their trading activities and so on and so forth. In terms of the impact for some of the large corporate customers that we support internationally, I wonder whether that possibly translates into an advantage from our perspective, in terms of if they were to repatriate – and by the way I think that's a big 'if'; it's a huge 'if', because unless they sort out the tax code, that will not get repatriated. Unless they provide exemptions around Subpart F, for example, it's not going to happen.

Chirantan Barua

But you don't see it as a massive liquidity event?

Iain Mackay

My own view is the more concerning aspect is when central banks conclude that they've got to try and figure out how to unwind QE, right? So then who invests in certain sovereigns bonds? If it's not the Central Banks in Europe investing in certain European sovereigns' bonds, then who does invest in those sovereigns bonds? You can go round Europe and look at the fact that 80% plus of the bonds being purchased by that sovereign are by the central banks. So when they start unwinding QE, what is the impact more in terms of sovereigns being able to fund themselves?

So I'm probably less concerned about the impact per se on the European banking sector or the corporate sector or necessarily even US tax policy that may result in a repatriation of funding sitting overseas, and more interested in what would happen when the Bank of England, European Central Bank and the Fed decide it's time to start sorting out their balance sheets. By the way, to which I don't think anyone's got the answer for that.

Chirantan Barua

Correct, which is why it's scary. The other one is the central banks obviously can control it; this one you can't control it. If they decide to repatriate in six months, its six months; the central banks if they're stressed, they'll stop.

Iain Mackay

Yes.

James Invine, Société Générale

The first question is on costs. So you are just towards the end of your programme to take out $6 billion. Before this one, you had another plan that took out $6 billion, so you're clearly a lot more efficient than you were. I was just wondering if you could characterise how efficient you now feel you are versus peers. Is there still a lot more work to be done after this plan or is that kind of it now?

Iain Mackay

Have you spoken to our customers?

James Invine

I am one, actually.

Iain Mackay

You can probably answer the question as well as I can in that case. There's a lot more to be done – a lot more to be done. The efficiency question – if you look at the last two and a bit years, part of it's been about investing and looking at real elements within the technology platforms of the firm. So how adept are we as an organisation and how open is our system's infrastructure to being rationalised, simplified, modernised, made more robust, made harder, made more secure, made more adaptable? There has been a huge amount of work done by Andy Maguire (COO), Darryl West (CIO) and our teams in that regard. And when you look at a great deal of where the savings are coming from, it's within the operations area, but also within the technology space. And part of that is about modernising the technology platforms, hardening the technology platforms.

There is obviously work also being done within the global businesses and within the functions around, how well do processes work? How high-quality is the data? Do we have all the data we need? If we have it, how do we get it into a format – or not so much a format but repositories, where we can then access it and then put it to use either for customer propositions, for risk management, for regulatory reporting, for stress-testing, a whole slew of activities that either we're developing because we think it's the right thing to do in terms of improving the customer proposition and the efficiency to the Bank or because it's being developed and required of us by regulators.

So, there's been very good progress made. It's a great question. I think if you asked Andy Maguire, 'Where are we on a continuum of 1 to 100?' on specifically technology Andy Maguire would probably give you a slightly different answer, maybe further ahead than the answer I'll give you – but I think we're somewhere north of 60%. But that still means there's a lot we can do, whether it's within the customer-facing processes. A lot of the work that John Flint (CEO RBWM) and the team are doing work around making it easier for people to interact with the Bank through a tablet, through a laptop, through their iPhone or any mobile device. And that has largely been focused on Hong Kong and the UK, but much more is to be done across deployment across the other 20 markets that really matter to John's business. But there is a broad piece of work there, much of which will be advanced significantly by the time we get to the end of 2017, compared to where we started in 2015, but will in no size, shape or form represent the end state.

And the same would be true of processes within each of our global businesses, within each of our controlling functions – whether it's Risk, Finance, you name it. And I'd like to think we go into 2018 talking about delivering sustainable cost productivity – depending on the environment, a couple of percentage points of cost productivity a year that allow us to accommodate inflation and allow us to create capacity to continue to invest in the growth of the Group.

It's not that I don't think we could set out another x billion target, but I think we've got to get away from being, 'Let's just do chunk after chunk after chunk,' to getting to, 'This is business as usual.' This is about building continuous improvement in what we do. You're not going to get a big investment programme to do it. You've got to create the capacity through delivering productivity year over year and deliver improvements from that productivity year over year. But in terms of capacity within the firm and opportunity within the firm to do more, there's still an awful lot we can do.

James Invine

Then the second question was just on the risk-weighted assets you're getting rid of. So, you're up to $280 billion at the moment.

Iain Mackay

Yes.

James Invine

I guess you've got a bit to finish off?

Iain Mackay

Global Banking and Markets, yes.

James Invine

Is it just a question of closing out those last little bits?

Iain Mackay

Well, for example, one of the largest areas within Global Banking and Markets that we need to close out is model approval with the regulators. So, the teams within Marc Moses' team and within the independent model review teams have built models, delivered them to regulators. The regulators, like the rest of us, are very busy and it's about working with them to get those models approved. And with those model approvals, that delivers some of the further savings particularly within Global Banking and Markets. We hope to get that by the end of this year, but if we don't get them this year we'll get them next year, which again, is just good in terms of keeping that capital deployment behaviour front and centre with all of our teams, both at a legal-entity level but also, at a Group level.

One of the areas – well, the key focus over the last two-and-a-half years has been around the PRA's risk-weighted assets. So, those are the ones represented in the Group's consolidated financial statements. But, when you look at capital efficiency at a legal-entity level, the RWAs that you calculate in Hong Kong are a little bit different – not hugely, but they're a little bit different to those that you calculate for the PRA's basis. The rules are a little bit different. There are things that Peter Wong and Kathleen in the team in Hong Kong can do that continues to improve capital-allocation efficiency in the Hong Kong environment.

By the same token, it's a little bit different in Singapore, a little bit different in Malaysia, a little bit different in Australia, a little bit different in Canada, a little bit different in Mexico – and hugely different in the US. So, there's an opportunity now to get more focused on not only what we do from a consolidated Group perspective, but get more clinical at a legal-entity level about what we do there. I mean, we've already achieved the FX-adjusted target we set out. There's more that we can do, and we will keep doing that. But the focus, again, is not to reduce the balance sheet; it's to make underperforming capital available for a range of opportunities, one of which and the most important of which, would be to invest in the growth of the firm.

Gurpreet Singh Sahi, Goldman Sachs

Can you update us on the scale-up of the investment banking operation in China and then getting multiple licences? I remember the same time last year we had been there and there were high hopes for what could be done. So, can you update us on what the progress has been? If there hasn't been so much, what has been the delay? Has it been on the regulatory front or something else?

Iain Mackay

So, we don't have the licence yet. I suspect Kathleen is the best suited to update you on that one.

Kathleen Gan, CFO Asia

Yes, we don't have the licence yet. That's the short answer. So, you know, once the licence comes into play, it will gives us the opportunity to have the full product suite for capital markets in China.

Iain Mackay

Participating domestically in China, absent that licence, is difficult to do.

Gurpreet Singh Sahi

A small follow-up: on the regulatory front, there's something called the Common Reporting Standard that many countries are now targeting to follow next year, sharing the information from a tax perspective of people who have multiple residencies, maybe, or kind of multiple personalities across banking sectors, sharing financial-asset information. So, can you talk how the Bank is kind of positioning for that and if that can have any impact on the industry at large in terms of movements of financial assets?

Iain Mackay

No, that's an easy one. We're front and centre on that. So, where Common Reporting Standard is being adopted by a country, then we are absolutely deploying across our customer base, across the network for the firm. You will recall we did a lot of work, and still are doing a lot of work, around FATCA (Foreign Account Tax Compliance Act). And CRS is a somewhat modified version of the US Act, which enables exchange of customer information in terms of foreign account-holdings to their taxing jurisdiction and free flow of information in that respect.

So, HSBC has absolutely adopted the standards and requirements of the Common Reporting Standard and we are deploying that in each and every market that has adopted it.

Robert Noble, RBC Capital Markets

Can I just follow up on the RWA question? Are you saying the next chunk – a lot of it will be model approval? How much was model approval in the past? So, will the revenue reduction be less?

Iain Mackay

So, I think, of the total, when we started in 2015, the total from model approval was just under $40 billion, I think, and it hasn't changed. And some of that has already been approved, but I think there's about half of it which we're still waiting for.

Robert Noble

So, you've done $20 billion and you've got another $20 billion.

Iain Mackay

Yes.

Robert Noble

And just on US rate rises and all the other linked economies as well, you've talked a lot about deposit betas etc. Is there any impact you can see on asset-quality stress? And, if not, at what level do rates need to get to before we start to see stress dramatically?

Iain Mackay

So, absolutely none at this point, as you might have guessed from our loan-impairment charge this quarter. Credit quality within our portfolio remains very, very stable. There are limited indicators suggesting stress is coming from a 50 basis point pick-up in the Fed rate. If you think about the portfolio that would have been most susceptible to that, it would have been our sub-prime portfolio – and we're down to $2.2 billion outstanding on that portfolio. And even that has performed better than expected over the course of the last two or three quarters with respect to credit quality.

When we underwrite mortgages, for example, as one product, we stress the affordability of that mortgage for the applicant to the tune of between 250 and 350 basis points. If they can't afford it at that level, then it's less likely that they would be approved. So, within that particular product range, interest rates need to do an awful lot more normalising. Circumstances change in households, obviously, but in the round, from a portfolio-underwriting and risk-management perspective, there's a fairly robust buffer sitting within the underwritten standard there.

Andrew Coombs, Citi

So, kind of a follow-up to Global Banking and Markets. A lot of the focus there has been pulling down the RWAs in order to improve the ROE of that area. As you said, you're 92% of the way there. A lot of the remaining RWA take-out relies on these model approvals. So, how much does the business now shift into being a growth area for the Bank again? Because you've actually been taking some market share in fixed income. If you look at your Markets business in 1Q 2017, it's up 29% year-on-year. That's actually better than, not only the European banks, but the best US banks as well. So, perhaps if you could just give us an update on what you think the growth prospects are, particularly given your different client base to peers, for the GBM division and, also, what you think about the ROEs of the individual segments. Because previously you've said that Rates and Credit have been below the cost of equity. Has that now changed?

Iain Mackay

Well, the last couple of quarters they've clearly performed much more strongly. I would not say that at any point have any of our global businesses, with the exception of Global Private Banking, gone purposefully ex-growth. Retail Banking and Wealth Management, Commercial Banking, and Global Banking and Markets have always been focused on growing the business. And if you go specifically to Global Banking and Markets last year, or rather 2015, one of the discussions in this room was, 'Well, if you take $140 billion of risk-weighted assets out of Global Banking and Markets, that clearly impacts customer relationships. What's that going to do to revenue?' And the number that Samir Assaf (CEO GBM) put out was that his expectation was that that would probably have a $400 million annualised impact on revenue. In actual fact, over that period of time, Samir and the team have taken the lion's share – they've got more to do – of what they've targeted in terms of risk-weighted-asset savings and grown the revenue base.

And, again, one of the responses Stuart Gulliver provided when we were discussing Global Banking and Markets numbers last week is that there is a lot of revenue that's coming through the Global Banking and Markets franchise which is flow revenue. Look at Global Liquidity and Cash Management. That's been a growing business now for most of the last eight or nine quarters. And it's not a business based on the vagaries of market volatility that disappears overnight – quite the contrary. I won't call it an annuity, but it's a stable revenue flow – the same from a Securities Services perspective.

Rates and Credit performed particularly well. Foreign Exchange, on much, much lower volatility in the first quarter, was the only business that we had in the Global Banking and Markets business, that did not grow its revenue. So, the business is very focused on growth. The question is getting that growth within our risk appetite and where the key markets are that represent that opportunity.

And clearly, where those markets have been both in the fourth quarter of last year and the first quarter of this year, has largely been in the Asian marketplace – not exclusively, but largely in the Asian marketplace. Those components where you would expect some volatility around the revenue are those components where you see it not only in HSBC but with our competitors: so that which sits within Global Markets or, if you want to use market parlance, more broadly FICC – so, foreign exchange, rates, credit, commodities. And, obviously, we're not a big player in commodities, so we're not necessarily either seeing the upside or downside of any volatility within that market. But the business has been and will remain very much focused on growing.

Paul Fenner-Leitao, Société Générale

A couple of debt-related questions. You obviously got a range of legacy securities outstanding, some of which are quite expensive, particularly the $25 par. And you've done an equity buyback; you're pretty well capitalised. And it looks as if, under the CRR2 EU proposals, that these things are probably not even going to count as MREL.

Iain Mackay

Yes, they amortise off.

Paul Fenner-Leitao

So, can you just update us on what you're intending to do around cleaning up legacy securities?

Iain Mackay

Our practice has been and will remain that when there is an opportunity to call a security that no longer represents capital value, or is inefficient from a financing perspective, we will call it, there are a couple of smaller liability-management exercises that we're contemplating within the business. They tend to be relatively small in scale, but we are primarily focused on making sure that anything we've got in the funding and capital stack qualifies as capital. So, as the values amortise off, then we will be more inclined to refinance those positions and ensure they have the qualifying criteria.

Paul Fenner-Leitao

Well, I guess a number of these are callable either all the time or every quarter. And, you know, they're already amortised by 50% in the full. These things are perpetual and they're quite expensive. There's no kind of guidance you can give us that this is something that might happen this year?

Iain Mackay

No, we'll do what we call liability management or just simply take some of the instruments out of play. We'll do that from time to time, but I'm not going to provide specific guidance around that. I think our track record on this is pretty straightforward, but there's more that we can do – and we will in the fullness of time. But I'm not going to get into specifics on that.

Paul Fenner-Leitao

Fair enough. The second question is on the issuance front. You've obviously got a programme to do AT1 and Tier 2 capital instruments. You've always previously guided that this was going to be out of the UK HoldCo, HSBC Holdings. Are you now going to be sharing that with the multiple points of entry?

Iain Mackay

So, for the meantime that's still the case. So, one of the things that will inform that is the guidance – we talked about it earlier – about MREL and TLAC from individual regulators. The US is possibly one of the more important there. And then the second is efficiency of access to market. Obviously, Holdings has a strong track record, but there are a couple of other operating banks around the Group like HSBC Bank plc, like HUSI in the US. The Australian bank has done a little bit. But there are very few legal entities we actually have in the Group that actually have, compared to the total, a track record, because their funding structure has been dependent on and very ably supported by a customer-deposit base, which, when you look at the behaviouralisation of that, across the different customer segments, has been very stable.

But, for the moment, the guidance is there will be senior-type issuances from those subsidiaries that have a track record of doing that. To the extent that it's MREL, it'll be coming from the parent company and downstreamed. To the extent it's AT1s or Tier 2s, it will be coming from the parent company.

Martin Leitgeb, Goldman Sachs

I have three questions, please. And the first one is on GBM; the second one UK ring-fence; and the third one on capital and dividend, and that is probably a little bit more complex. But, to the first one, GBM – you had a very strong first-quarter result compared to some of your European peers in particular. And I just wanted to pick up on some comments over the weekend on the ability to use more of your balance sheet, in particular within Rates and Credit, whether you could give us a little bit more colour on what form and shape that takes and how we should think about that going forward.

The second one, on the UK ring-fence: I was just wondering how you see UK mortgage growth at the moment. Is that now the kind of steady-state rate we should think about, roughly 6% growth annualised, or do we think there's further scope to accelerate that growth and redeploy some of the excess deposits you have within there?

And, finally, capital and dividend – a little bit more complex. A couple of sub-questions to that question. But the first one is on the UK bank plc, HSBC Bank plc. Could you update us on what the capital ratio there was, as of first quarter? I'm not sure whether you disclosed it – I think it's half yearly – just to see how much of the capital benefit from the first quarter was within that entity. The second part: we obviously noticed the increase in dividend from Hang Seng; how should we think about that going forward and the implication? And, thirdly, on the US dividend, could you just update us on timing? How should we think of timing? Obviously, with the CCAR, we have the results in June. Is it something which would be immediate? And I'm not sure whether you can update us on the number which you have received in the meantime from the US?

Iain Mackay

So, the dividend that was paid by the US subgroup to the parent was $2.5 billion. That was upstreamed to the parent group in the first week of April. The timing of any further dividend, I'm afraid, lies entirely at the discretion of the Federal Reserve. So, we've applied. We've submitted a capital plan as part of CCAR that includes dividend. The timing of that is blended between the second half of this year and next year, but one of the elements of feedback we will get back in July is whether or not they agree with the quantum and the timing. If there's no objection, then there may be some in the second half of this year. If there is some kind of objection, what is afforded is that you're given about a week, 10 days, to revise your capital plan. And then perhaps that revised capital plan receives no objection. But, frankly, until we get some feedback from the Federal Reserve, it's impossible to guide you more than that on that particular question.

In terms of Bank plc in the first quarter, easy to find out – and we'll get back to you, but I don't know what it was.

Richard O'Connor

We update twice a year on that. And with respect to Hang Seng, you saw the increase in dividend. It's for the Hang Seng board to announce that.

Iain Mackay

So, what that means is we own 62.41%. We get 62% of that. That dividend flows to HBAP; that provides capital resources to HBAP, which they can either deploy or they can upstream to the parent company, to Group. No other implication than that – it's just more cash flow upward flow potential, right?

Around the mortgage book in the UK, we would like to be more than 7% of market share, so we've expanded the brokerage network we engage with, that we can distribute product through. The underwriting remains absolutely 100% under the control of HSBC. So, yes, we would like to grow. The rate of that growth will be informed largely by, I think, economic development, demand – and demand from the kind of customers that we like to extend mortgages to. So, again, it's not exclusively, but it tends to be focused on the Advance and the Premier offering within the UK.

But we continue to expand the proportion of the market that we see by engaging more brokers, as we put them through the due diligence process, as they're willing to work with us and us with them. So, we are seeing more and more of the UK market, which clearly makes our potential to grow within that. It is also an extremely competitive environment. It's one of the areas we see a little bit of spread compression on assets – although it's fair to say that continues to be a very profitable product for us in the US. So, that was margins; that was capital. And the other one was…

Martin Leitgeb

GBM Rates and Credit, and balance sheet.

Iain Mackay

GBM Rates and Credit, and balance sheet. I think, again, I'd go back to my earlier response in Global Banking and Markets. Samir and his colleagues, Matthew Westerman and Robin Phillips, co-heading Global Banking, and Thibaut De Roux heading up Global Markets – they are focused on growth week-in, week-out, and growth across each of the product lines within their business.

It's not that they would single out, other than opportunistically, and say, 'Look, there's a market that's good at the moment. We've taken market share; we've got a good product offering. The technology platform off which we do it is basically a corporate-treasury platform, which means we can see what's going on in many, many markets across the world.' But I'm not sure necessarily they single out Rates and Credit as areas of growth within Global Banking and Markets. And we're absolutely willing to put more balance sheet to work. We've freed up an awful lot of risk-weighted assets, but we're willing to put it to work with customers and products that generate returns in line with the targets we've set.

Rohith Chandra-Rajan, Barclays

A couple of quick follow-ups, please, if I could. The first one is just returning to margin. And you talk quite a lot about HIBOR on the call. It kind of came down through the course of Q1, as you mentioned. It looks like it's fallen a little bit more in April. If it stays at current levels, could you give us an indication of what that would mean for the margin? What would the 164 move to?

Iain Mackay

No, I can't give you that guidance. Let's put it like this. Sarah Legg or Kathleen Gan can correct me on this, but if you've got a savings account with HSBC in Hong Kong dollars in Hong Kong, you're getting about 0.001%. So, there's not much further down that track we can actually go. If you get better alignment between the Fed and HIBOR than there is obviously upside for us – not only across the US dollar deposit base, but, more prominently, across the Hong Kong dollar deposit base. How to model that out… We can obviously model lots of different scenarios, but to give you guidance as to what that might mean for next quarter and our net interest margin – no.

Rohith Chandra-Rajan

And then just very briefly on the UK mortgages, just to follow-up, how much of your origination is now through the broker channel?

Richard O'Connor

Last year it was 7% of originations, and Q1 was 16%.

Stephen Andrews, Deutsche Bank

One of the highlights of the Q1 numbers was just the strength in Hong Kong from a revenue perspective. It was incredibly strong. I think we kind of all get the HIBOR issues, with that going up, but specifically the Wealth Management business as well – can you give us a bit more colour as to why the strength there? I know we've seen across the street Singaporean banks all beat expectations there. What sort of product are people buying? I think you alluded to increased investor confidence. Given the China markets had a pretty big hiccup in the last sort of month or so, is that now ebbing away? And then just the last point on that, on the $138 million insurance-manufacturing market impact that you flagged in Q1, I think there was about a 400 million swing year-on-year. How much of that was actually in the Hong Kong Retail Banking and Wealth management division that was showing such strong growth?

Iain Mackay

So, the two big insurance-manufacturing businesses we have are Hong Kong and France, and Hong Kong is the largest by a significant degree. To the extent you see market updates coming through PVIF, it is nearly always the lion's share coming from Hong Kong and some proportion coming from France. Again, the exact dynamics of that depend on market movements and the underlying securities in which it's invested, both in the European and Asian marketplaces.

But I think the movement in the market update for the first quarter of this year was $138 million positive, and it was compared to $168 million negative in the first quarter of last year, and that accounts for the swing. So, that then goes on to a very strong performance, on a year-over-year comparison. But you'll also remember that the first quarter of last year was a bit of a shocker, not only for Retail Banking and Wealth Management in HSBC, but the entire market in the first quarter of last year. And I think everybody was well and truly worried that China was about to go through some sort of life threatening event, which clearly didn't transpire. So, I think what we've seen is something that is more reflective of a normal first quarter coming out of the Retail Banking and Wealth Management business in Hong Kong.

We obviously saw a little bit of margin expansion in the liability side coming through Retail Banking on current accounts and deposit accounts. We saw a lot of appetite for mutual fund-type products through Asset Management. We saw a lot of new insurance-product distribution, so obviously net new premiums coming through the door. So, just literally across the board, through the first quarter, it was a fairly robust environment for Retail Banking and Wealth Management, not only in Hong Kong but further around the group. It was a pretty positive picture.

In April, the trading in Retail Banking and Wealth Management has been reasonably positive. The markets have been slightly less positive, so it wouldn't surprise me to see a negative PVIF adjustment coming to you in April. But in terms of customer appetite and volume, I think it's been reasonably positive. Kathleen, I don't know if you'd add anything to that.

Kathleen Gan

I think you're right to say that insurance manufacturing – a big part of the positive market condition update is in Asia, about $193 million positive for Asia. We're seeing strong growth in wealth management in 1Q. As Iain has explained – at 1Q16, we had a pretty challenging market environment with equities turnover almost half of 2015. So in 1Q17, it helped in terms of seeing higher unit trust volume that comes through, and stronger retail securities brokerage in Hong Kong and China.

Raul Sinha

Can I just get your thoughts on the progression of the Core Tier 1 ratio? At 14.3%, I guess the problem the market has – it's a good problem to have, that your underlying capital generation is running at around 30 basis points. Even if you do initiate a buyback in the second half of the year, it's quite unlikely to see your Core Tier 1 ratio going down, apart from regulatory changes. And the higher you run with the Core Tier 1 ratio, the more dilutive your ROE becomes at the Group level.

Iain Mackay

Indeed, because it's more difficult to reach that 10%.

Raul Sinha

Exactly. So the problem is compounding itself now, in terms of the capital position. Also you're managing the divisions on RoRWA. So essentially, if you don't hold the capital of the divisions back at 13%, then essentially, through the senior management decisions, your ROE gets diluted even further. And so the question really is: is the reason you're holding such a big buffer because of the regulatory change concern that you have on IFRS 9 and Basel IV? And how should we think about the timeline, because those might be quite long dated in nature? How should we think about the timeline of that capital ratio evolution going forward? Does it come back to 13% at the end of this year?

Iain Mackay

No, it won't come back to 13% at the end of this year. I think at the end of the year we talked about running higher for the medium term, because part of it we've got to get surpluses back to the centre. The capital ratios of the Group is made up of basically the consolidation of the capital ratios of our subsidiaries. And the capital ratio of the subsidiaries have variabilities. Some of our regulators require us to hold more. Some of our regulators don't require us to hold more, but have had us hold more, for example in the United States, to a lesser extent in Switzerland with the Private Bank, to a lesser extent – well, actually, structurally in Singapore, because there was a requirement to create a ring-fenced bank in Singapore, and to a lesser extent, in mainland China, where we've been deploying capital to grow the business over the last few years. It's a profitable business, and we've got to start the practice of getting dividends out, which means there's a piece of work to do with the regulators to build the rhythm of actually paying dividends as opposed to reinvesting in the business.

And that goes to that point I made earlier about focusing on local RWA optimisation, and then optimisation of the capital ratio at the local level. But fundamentally what we need happening is that all of our major subsidiaries, whether it's the US, whether it's Canada, whether it's Australia, whether it's Hong Kong – we don't have this problem with Hong Kong, thank goodness – generating the profitability that creates distributable reserves upwards that allows us tocontinue to support the dividend, and grow the dividend in the longer term, but also to create that capacity to deal with dilution, which obviously, as we continue to generate capital every quarter, as we nearly always do, it just adds to the challenge of how we get that capital ratio back into the 13% range over the medium term. But it's going to take a few years to do that. It's going to take us a couple of years to do that.

If you just think about taking three to five years to get all of the capital out of the US, that's a component of it. So we're going to run heavier than the 13% for, my guess is, the next two to three years at least. Which makes – we're still aiming at 10%, and we see the propensity to get to 10% even with that higher capital, but there's a piece of work here that takes a little bit of time. Well, more than a little. It takes a few years to get this balanced right at the centre.

And there's also – I'm less concerned – maybe I shouldn't be, but I'm a little bit less concerned about where Basel takes us in terms of Basel IV revisions. The market's become rather blasé about that. I think possibly banks have become rather blasé about that, and I think that's dangerous because we don't have a known outcome to that, and there is risk that there could be RWA inflation coming from Basel IV that could impact the industry and us within it.

IFRS 9, it's not so much the adoption upfront that concerns me, it's more the volatility of it quarter to quarter. We'll get guidance to you during the third quarter around what the initial adoption means. Whether we'll be able to give you guidance about quarter to quarter I think is much less likely. But we'll work through – we've done dry runs. We're working through parallel runs now. And we want to get to the position that we've got a high level of confidence from data that we put in front of you. I don't want to give you guidance and then turn around two months later and go, 'Well, actually, we were 10 basis points off. This is what it's going to be.' But we'll give you guidance on that some time in the third quarter. It might not be with the first half results. It'll really just depend on where we get to around the parallel runs across all the major legal entities. Because again, this is not IFRS 9 for London; this is IFRS 9 for 70 countries around the world, and getting a consistent adoption of that. Again, it's not so much the upfront adoption that worries me enormously around that; it's more the volatility around it.

We've a challenge around getting the consolidated ratio. You can look at the UK and the UK will be absolutely in a fine place. When you look at them individually you can go, 'right, US is over-capitalised. There's maybe a little bit of spare capital sitting in Switzerland. There's maybe a little bit too much sitting in China. Now what do we need to do with each of those regulators to get back?' Thus far, the most challenging has been making sure we get good outcomes on CCAR, and then not only good outcomes but adding to the outcome by getting dividends into the annual capital plan, which supports it. Do we get back to 13% by the end of the year? Not unless the RWA inflation that we all feared a year ago suddenly shows up, but I don't expect that, no.

Katherine Lei, JP Morgan

So my question goes back to Hong Kong. It's on loan growth. Hong Kong loan growth has been very strong in the industry overall. I think it's over 10% YOY. What is the guidance for loan growth for this year? And also I think part of this loan growth in Hong Kong is because of China entities borrowing for M&A. Do we get a lot of the china fund, or do we reject those demands, or do you think that from a risk perspective maybe it's not worth going after those loans?

Kathleen Gan

We've started building momentum on the balance sheet growth in the third quarter last year. So what you're seeing in the first quarter is the continued momentum of growth we've seen in the third quarter through fourth quarter last year and into 1Q this year. I think the momentum is driven by a few factors. One, there's a slightly more positive sentiment in the marketplace, and we're starting to see commodity prices stabilising, and we can see improvement in trade flows. Mortgage growth has continued to remain strong. And whilst on the wealth side it's more fee income growth we have seen good growth around Credit and Lending with a good pipeline that's started converting, so there's nothing special or unique. Just better market sentiment and more stabilised commodity prices.

Kathleen Gan

Hong Kong year on year is 14%, and discreet quarter growth it's about 3%.

Tom Rayner

I just have a follow-up question on the cost programme. You said 60% through what's achievable, a bit more on technology. Should we be thinking next time you present to us on one of your strategy days we're going to have a new number for gross cost savings put out there, and if we do are we going to have a below the line restructuring charge to go with it, or from end 2017 onwards is it pay as you go, so to speak?

Iain Mackay

My very strong preference is that we focus on cost productivity year over year, accommodating inflation and creating capacity for further investment in the processes, technology and capabilities of the Group. I think we have to move beyond big programmes that are financed out of special charges. You're always going to have some restructuring, because there's always restructuring going on within the Group, but those should be, I think, more episodic as opposed to programmatic. And my very strong preference would be that we set targets focused around positive jaws and cost productivity that can be identified. And again, one thing that has kept our management team very, very focused is having an exit run rate. So every month when we sit down we look at: what is it that we're investing in the savings? Are we delivering savings? What are the resources we've got deployed on that? Over what period of time do those resources run off? Over what period of time does that expenditure come to an end? Which is very much targeted in coming literally to a hard stop on 31 December 2017. And one of our goals has been to create that capacity within our organisation, dare one say the culture within the organisation: there is day in, day out a focus on delivering efficient outcomes and improving the cost productivity of the firm.

So that would be my preference. As you know, we've got a new Chairman on 1 October, and he will set about the business of identifying somebody to succeed Stuart at some point in 2018. Again, at the risk of speaking slightly out of turn, when Stuart talks about strategy – not so much strategy, he's been talking about targets for mid-year, it's unlikely that Stuart's going to lay out some new, wonderful, whizz bang strategy when you've got a Chairman walking through the door a few weeks later, and a new CEO in 2018. My guess, well, my view is we'll update you on targets, what we would expect to accomplish through the end of 2017, what we'd expect to be focused on in terms of key management metrics and key performance indicators beyond 2017 into 2018, and possibly beyond in terms of setting out a consistent pathway there. Stuart will absolutely give you context around what strategically is working, what strategically needs more focus and attention within the context of what we set out to do in 2015, what we've accomplished, what we still need to do. But at the risk of speaking out of turn I wouldn't expect a massive reshaping of the Group to be announced at the mid-year.

Iain Mackay

Thank you very much for attending.