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Transcript

Post Results Call
Q3 Analyst Meeting

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EWEN STEVENSON, GROUP CHIEF FINANCIAL OFFICER: Morning or afternoon all, depending on where you are in the world. Thanks a lot for joining. I've got a few colleagues on the phone, various folk from IR who you'll all be familiar with, Ming Lau, my CFO in Asia who some of you will know.

Just a few quick introductory remarks from me and then we can move to Q&A pretty swiftly. Hopefully you picked up a more confident tone from Noel and I at the 3Q results announcement last week. We do think the results were decent. It was another good quarter for Markets, but I would just foreshadow, I think there's a progressive reverting to normalisation. We'll see out of the US election, or the latest COVID goings-on, increased volatility back in the market, but we are seeing, I think, as the year progresses, progressive reversion to norm.

Another positive performance in Asia, albeit, as you'll all have seen, we are grappling with near-zero interest rates, and obviously in Hong Kong that translates very quickly into the P&L. Credit conditions are stabilising. The important shift, I think, between second-quarter and third-quarter results was no material movements in forward economic guidance. And costs continued to track to around 3% or $1 billion lower for full-year '20.

On tax, I think there was a bit of confusion about the high reported tax rate of the third quarter. It's overstated materially versus what we think the effective tax rate is. There were some software intangible write-offs and a DTA write-off in France that heavily impacted the reported number. I think we should continue to assume that the effective tax rate is in the low 20s, particularly given the high contribution of low-tax Hong Kong earnings.

We do think that downside risks in aggregate have reduced materially over the last few months. Despite what we're seeing in COVID at the moment, we do think the more extreme COVID-19 downside risks are a lot less pronounced than earlier this year. And I say that because the path to a vaccine is now much clearer, so the prospect of a sustained "U" happening globally we just heavily discount. We can also see that, despite ongoing significant impact for COVID in US, UK, Europe, and places like India, other parts of Asia Pacific are recovering fast out of COVID-19 lows. There's obviously a couple of events on the horizon that we're watching: the ongoing Brexit negotiations, the US election in the next few days. But, as I said, in aggregate we do think downside risks have reduced.

Hopefully you picked up and saw that we're making good process on the restructuring we announced in February. We're just over 40% of our way through now the RWA run-down programme, set to be halfway through by year-end. We're now signalling we expect to go further than the $100 billion by the end of 2022 without increasing the $1.2 billion spend budget. Our restructuring programme, as you know, was paused in lockdown one around March, April, May. As a result, the cost programme is one to two quarters slower than should be the case at this point, but we have taken $600 million of costs out under that programme in the year-to-date, and we expect to be at about $1 billion by the year-end.

But importantly, we are signalling that we expect to deliver more than $4.5 billion by 2022. I think there will be some incrementally higher costs to achieve or restructuring costs as part of that. Previously we talked about $6 billion driving $4.5 billion of annualised savings. I think you should just assume that restructuring cost ratio of about 1.33 is the way to think about higher costs taken out and higher restructuring charges.

We do expect to now exceed the $31 billion cost target. We expect actually to get there a year earlier in 2021, but that, at this point, I think, is built into consensus. There are three big drivers of cost coming down. One is the ongoing restructuring that frankly we started in 2019 and have continued through 2020. There are some quite material impacts because of COVID-19 this year, a number of which we think we can now institutionalise into our cost base. And, obviously, there's the medium-term upside from the leap in productivity from technology. I think it's too early at this point to quantify the medium-term view on all of that on costs and we will provide more colour at full-year results.

Despite the reduction in operating expenses, we still are making high levels of investment. We've got a lot of new stuff coming through for customers: PayMe, the peer-to-peer, and now B2C, personal wallet from Hong Kong; Mobile X, our technology platform for Retail; Kinetic, our SME online bank; investments in blockchain and trade; HSBCnet for mobile for our corporate customers. COVID-19 has definitely accelerated that shift to digital, and we're seeing, as a result, significant take-up on these platforms. And we also have got some good transformative stuff going on in the back office, like in my own area a project called Finance on the Cloud.

The path back to dividend resumption, I think, is clearer. We do think we're putting the building blocks in place: a high common equity tier 1 ratio, a set of downside risks that are now more manageable. But, as I said the other day, please pay attention to the word 'conservative'. It means what it says on the tin.

And then beyond 2021, I think Noel and I clearly recognise that we need to get back the 'cost of equity plus' returns over the medium term. As you know, we're currently well below this, but we think we have got a credible set of actions to deliver this, but it will involve a multi-year shift on the revenue model, cutting costs much further and credit normalisation. And we'll talk more about all of that at the full-year results.

So with that I was going to stop and open up for questions.

RONIT GHOSE, CITI: Just a couple of questions, please. On the medium-term ambition of ROE above cost equity, Ewen, can you just remind me what cost of equity you guys are currently thinking about over the medium term? That's the first one.

The second question is on the dividend. It's what it says on the tin. How shall I interpret 'conservative'? Should I be thinking, going forward, earnings pay-out ratios become much more important? Many European banks guide to 50% of underlying pay-out on earnings, something like that. Is that what I should be assuming?

And linked to that, my final question is on share buybacks. Given you've got a lot of capital, and you're talking about uncertainties coming down, path to vaccines, could you talk a little bit more about why on the earnings call you seemed to basically dismiss the likelihood of share buybacks anytime soon? Thanks for that.

EWEN STEVENSON: On medium-term cost of equity, I think, if you had asked us pre-COVID, we would have said 9. Richard O'Connor's on the call. He and I both think we've drifted up since then. Somewhere in the 9.5 to 10 range would be our view today, and we're doing work at the moment as we speak on our annual piece of work on cost of equity, which we'll have finalised in the coming months. But somewhere in that range of 9.5 to 10 at the moment, I would say.

On 'conservative', I think I would distinguish between the Q4 dividend of this year, if we are able to pay one, versus resetting the dividend policy for 2021 and beyond. As you all know on the call, and I've been reasonably vocal about this as well, we previously had a policy of paying out 51 cents with an aspiration to keep that stable to grow earnings to make that more sustainable. It was putting an unbelievable amount of pressure on the bank as a result, in some ways in a good way because it was forcing us to recycle out of low-returning RWAs. But what we'd like to get back to, I think, is something that we feel is sustainable.

If you think about those medium-term returns of capital, for example, we want to retain some capital to be able to grow the bank, and potentially both with small inorganic within that as well. That would naturally lead me more to think about pay-out ratios, but we're in the middle of doing that work at the moment. We recognise too that we've got a shareholder base today that's very income-focused, and so there's a whole bunch of considerations that we need to take into account. But what we don't want to do is get back to a place where we've created a dividend policy that we don't think is sustainable over the medium term.

And on buybacks, I didn't mean to discount them. I do think they should, and have been, and will be, an effective tool in our capital management armoury. I think I was just cautioning the fact that there's still a lot of uncertainty out there in 2021, however people want to characterise it. It may be less than this year undoubtedly, and certainly going into the start of the year, I think we're going to be pretty cautious about that uncertainty. I think, until we see a definitive path out of COVID, which probably means an effective set of vaccines and a return to normalisation of the global economy, we're always going to have a degree of buffer capital to deal with uncertainty. But we're not discounting at all buybacks as something that we would use if appropriate.

RONIT GHOSE: Thanks, Ewen.

BENJAMIN TOMS, RBC: Two for me, please. In relation to the lockdown announcement in the UK over the weekend, does this impact your guidance of the lower end of $8-13 billion range with impairments for 2020 or the very rough in-between $4-6 billion for next year? And then secondly, can you talk a little bit more about the potential to start charging for basic banking services? In what geographies and products could we see changes? Thank you.

EWEN STEVENSON: On the lockdown, the thing to watch is, how does forward economic guidance change from here for the UK, Europe, and the US, for example, which seem to be more impacted by the second or third wave of COVID coming through? If that forward economic guidance is going to deteriorate, it will translate in us needing to take additional reserves at the end of the year. I don't think that changes the guidance we gave last week. It may shift us to a different point in the lower end, but it doesn't change the guidance.

On basic banking, I created a bit of a storm last week, which was not entirely intended – we're not rushing to suddenly charge for current accounts. What we wanted to do was start a conversation about the fact that, in a world with near-zero interest rates, the basic charging model for a lot of deposit customers doesn't work, particularly around current account services, particularly around the world where we are providing an awful lot of service for limited return, and large numbers of customers are losing us money if they just have a basic current account.

So we will always – here in the UK, for example, we have to offer a basic current account, which we'll do. But we do think we are going to have to progressively engage deposit customers, whether they be retail or corporate, on how we shift the economic model to more a fee-based model, and there are various ways of doing that that don't necessarily involve just charging fees for a basic current account. But that comment was obviously taken out of context in relation to a broader discussion on a press call and became front-page news in a way it wasn't intended to.

BENJAMIN TOMS: Thank you very much.

TOM RAYNER, NUMIS: Just on costs, Ewen, is there a hard floor in your mind on where costs might need to get to – because if you look at what consensus – and my own forecasts, in a way – are looking at you getting to a return of around 7% in the next few years. You need to find very roughly $5 billion per annum of extra revenue, or $5 billion per annum of additional cost savings, which would clearly drive costs – if the revenue wasn't recovering as hoped, you would need to drive costs down to a level that we haven't really seen to get back to a cost-income ratio in the low-50s.

And is there a level where you think you can't really go, and it's going to have to become more of a revenue story at some stage, or do you think if the revenue environment remains fairly tough for even longer than expected, there are other things that should start being looked at? It's probably a question for February, but anyway, I thought I'd give it a go.

EWEN STEVENSON: First of all, I'm not going to comment on the maths in your model that gets you to your 7% return. Do I think there's an absolute level? I would like to think the answer to that is: nothing that's realistically in anyone's numbers. And I say that because I do think that, over the next five years, some of the opportunities that are opened up by technology change are vast, and it's beholden on us, and other banks, really, to take advantage of that opportunity.

So if you look in distribution costs, COVID has definitely accelerated the shift to digital. Digital distribution is a fraction of the cost of physical distribution. And there, you're engaged in a debate of, 'What of the old economy distribution model, the basic product, do you need to have? How many branches do you need to support a business model that is largely digital first?' For Relationship Managers I'm assuming that over the next few years we'll be able to drive massive productivity improvement because, again, of the benefit of technology.

When you go into the back office, we have thousands and thousands of people doing very manual stuff that can be automated over the next few years. If I look at my own part of the bank, I've been very open with my own team that we're working on a project at the moment called Finance on the Cloud where we're going to shift all of our internal and external reporting onto the cloud over the next three or four years, which will reduce the cost structure and finance by a third, and take headcount down by a third.

It's that sort of shift in productivity that I think we're going to be able to achieve progressively over parts of the bank – massive productivity potential. Commercial real estate is a new area that we've been applying ourselves to post-COVID. Pre-COVID, we would have thought that what we called desk-sharing ratios would have topped out at 1.4, i.e. you had one desk for every 1.4 people trying to use it. We're now testing whether we can take that up to two, two and a half, or even double it, which over the medium term, as lease contracts come up for renewal, should mean that we'll be able to drive commercial real estate costs down materially.

Video technology I think that we've all now tested over the last six months has meant that we can completely revisit the previous business model of flying people all over the world and drastically reduce our travel bills. I think over the longer term we can even rethink whether we need to have everyone sitting in expensive head office infrastructure in major metropolitan cities of the world or whether they can sit anywhere.

So I do think we are at a tipping point on technology. I do think that opens up a massive opportunity to drive costs down. I think we're going to need to do it because we're going to face an array of new competition that's going to be predominantly digital and automated. But the opportunity on costs, I think, is a multi-year opportunity just to continuously drive down costs in the bank. But you're right; we'll come back at full-year and talk more in a quantified manner about that.

RICHARD O'CONNOR, HEAD OF GLOBAL INVESTOR RELATIONS: Tom, just to say we're certainly not giving up on revenue growth. We operate in economies which do grow and we do expect a bounce-back in activities whenever COVID is in the rear-view mirror, in Western and Eastern economies, and you'll see in Eastern economies already. And at some stage that will happen in the West as well, so, no, we're certainly not giving up on the revenue growth in those economies which have the ability to grow much faster than world GDP.

TOM RAYNER: Ewen, is it more sensible maybe to look at costs versus assets, costs versus maybe risk-weighted assets? If I go back over 20 years, I don't think you've ever dipped below 3% of RWAs. Is that the sort of thing that technology changes and all these things you were talking about – maybe that previous benchmark is something that could be tested going forwards? Is it more sensible to look at it on that basis?

EWEN STEVENSON: Absolutely. The other thing is – do pay attention to what's been going on in the last couple of years. When I arrived at the bank in 2018, we grew our cost base 5.5%, 5.6% that year. We went into this year with flat cost growth; we're actually going to achieve cost growth of probably -3%. The cost discipline in the organisation has shifted materially in the last couple of years in a way it never had previously.

TOM RAYNER: Okay. Thank you.

AMAN RAKKAR, BARCLAYS: Can I ask you first on non-interest income in 2021, please? I guess the two key drivers of that will be GB&M and the Wealth and Personal Banking division. On GB&M, to what extent do you think the division's made a bit too much revenue this year given the buoyant broader backdrop that it's operating in? Do you expect that to fade next year, particularly given restructuring? I know it's quite hard to predict that revenue line given its volatile nature.

EWEN STEVENSON: Look, there's definitely been revenue outperformance this year with us and everyone. But equally, I think we think 2019 was weaker than trend too, so somewhere between those two levels.

AMAN RAKKAR: Okay, perfect. Can I then ask on Wealth Management and to what extent you'd expect that business to recover? My understanding is there are elements of that business that are quite hard to do in a socially distanced environment, but there are other elements that potentially do a bit better. Could you help us understand that momentum into next year, and do we expect a recovery in that?

EWEN STEVENSON: Yes, we do expect a recovery. You're right that parts of the business are dependent on face-to-face contact or parts of the business are dependent on Mainland Chinese tourists being allowed back into Hong Kong. So we do think there will be recovery in 2021. At the moment, where we're finding it hardest is in new-to-bank customers which are dependent on face-to-face interaction. So it's hard to generate an ultra-high net worth new business customer in the Private Bank unless you've met them, but I do think, given the predominance of Retail non-interest income is in Asia, and they are coming out of COVID more quickly than the worst – we will see a recovery next year.

But some of it means – Ming the Hong Kong CFO is on the phone and may want to comment - but for example, there's a big issue as to when Mainland Chinese tourists are allowed back into Hong Kong, which current indications are sometime around the end of this year. But Ming, I don't know whether you want to add?

MING LAU, CHIEF FINANCIAL OFFICER, ASIA PACIFIC: In a BAU environment, we've got about 30% of our Wealth and Insurance sales in Hong Kong that are dependent on Mainland Chinese clients and visitors into Hong Kong. And the environment on COVID can be volatile. But if you look at what's happening on the ground now in Hong Kong and in China, I think the COVID situation has been pretty well managed. So Hong Kong, I think the thing to watch is the local-transmitted COVID cases, and at this point, in the past several weeks, it's been less than a handful of locally untraceable COVID cases at this point.

So assuming that trend continues, I think there's a good chance that the border between mainland China and Hong Kong will gradually start opening. It won't completely open immediately, but I think the indication now is they'll look to gradually do that and perhaps offer a quota system on that. So look, I think – so there is some potential uplift in terms of Wealth sales and Insurance sales coming from that, assuming that that improves.

I think the other thing for Hong Kong, China to keep in mind is that the Guangdong government are looking at Wealth Connect schemes between Hong Kong and China. No clear indication of timing yet in terms of when that's going to come through, but when that comes through that also could potentially give us a bit of a boost in terms of onshore mainland Chinese Wealth sales and also the bits into Hong Kong.

AMAN RAKKAR: Perfect. Ewen, just one other quick one. On the UK mortgage market, just what's your appetite currently? Obviously, conditions are pretty buoyant in terms of volume, spread, etc. Do you think it's sustainable? Are you changing your stance in that market? Is there any kind of update you can give us?

EWEN STEVENSON: I wouldn't say we've changed our stance. I would say that the big reason for the uplift in Mortgage flow share in the third quarter – in July and August, we haven't got the September figures, we're doing around 13% plus flow share, which is obviously above a 7% stock share - I think it was largely driven by relative operational issues that we've all been having and our capacity to handle demand. And I think there's been a real operational constraint on the sector. So I think that'll normalise, but we haven't changed our stance. Depending on where COVID-19 gets to, the outlook for unemployment, where we get to on the Brexit negotiations may result in tweaks to risk appetite as we progress over the coming months, but we continue to broadly be very liquid in the UK, have plenty of capital and I'm happy to take flow market share well above our stock market share if we can. And I think the other thing that's obviously been done a lot in the last few years is an enormous investment into improving our broker distribution, which is beginning to bear fruit as well.

RICHARD O'CONNOR: I'll add two more things. There is a lot of remortgaging with people on lower rates and that's fine, but we do expect, obviously, good volumes up until the end of March, when stamp duty changes and then it could be the market gets a bit quieter after that. We'll have to wait and see.

AMAN RAKKAR: Thank you both.

STEVEN CHAN, HAITONG: Two quick questions from the regional analysis. We take a look at the 3Q pre-tax profits on a regional base. The interesting thing is that the pickup from 3Q to 2Q came from the UK ring-fenced bank, from non-Hong Kong/non-China Asia and from Latin America. First of all, what has caused the pickup in earnings in the 3Q for Asia - which part of the region and what type of business? And will these three regions - the UK ring-fenced bank, Asia non-Hong Kong/non-China and Latin America, sustain this momentum of pre-tax profit in Q4 and the coming quarters?

The second part is, Hong Kong and mainland China pre-tax profit is a bit disappointing, especially over the weekend we have another of your competitors in Hong Kong releasing results. They report post-provision profit in 3Q has seen a rebound relative to the second quarter, and at the same time we've seen most of the mainland Chinese firms report a 3Q rebound in their pre-tax profit as well. So my question is - what happened to Hong Kong and China? Why didn't you see a rebound in 3Q results and when are you going to see your pre-tax profit bottom out and start to pick up? Thanks.

EWEN STEVENSON: There's a high-level answer to a lot of all of that and then I can let Ming talk about Hong Kong specifically, but there were two big drivers of a big shift in profitability on Q3. One was just a very different position on ECLs. So if I look at the ring-fenced bank, for example, the pre-tax profit improved by $1.4 billion and I think $1.3 billion of that was a change in ECLs. Similarly, in the non-ring-fenced bank, most of the improvement in profitability was driven by a shift to much lower ECLs. So Q2 was unusually high because of the impact of forward economic guidance. Q3 has been talked about as probably unusually low in terms of ECLs by a few hundred million, but I think that recovery from the trough of Q2 is certainly sustainable.

The other big shift is obviously the impact of interest rates. Where that was most pronounced was in Hong Kong, because we've got a very short-dated book there on the assets and liabilities, so that was a significant driver of the reduction in profitability in Hong Kong. It hasn't really changed any of the fundamental business drivers of what's going on there. Ming, I don't know whether you want to add.

MING LAU: Yeah, thanks, Ewen. For Hong Kong, I think there are a few bits I would draw out. One is on net interest margin overall. So net interest margin continues to be impacted by the fall in rates, particularly in HIBOR we saw feeding through. If I look at the overall region, average net interest margin was 144 basis points for Q3, so it's a drop of 25 basis points relative to the second quarter. So the revenue fall-off you're seeing is largely reflecting that.

I think on a positive note for margin, I do see that we are in the trough in terms of the margin compression overall for the region, so we did see a bit more stabilisation in net interest margin through August, September, and that's been helped by slightly more stable and elevated HIBOR rates. That's been impacted or helped by the IPO activities in Hong Kong and impact on liquidity. Secondly, I would say for Hong Kong and the region in Asia, third quarter Global Markets revenues were lower relative to the second quarter. So across the board on most products we saw less volatility in the market overall in the third quarter. That impacted Global Markets.

And lastly, I would say, for Hong Kong specifically, with the pickup in the equity markets and volumes through the third quarter, we actually saw a strong performance on the Wealth Management side, in particular from brokerage revenues. So sitting here now, I think on net interest margin we're in the trough and I think on Wealth we are seeing at least some small signs of pickup in activity at this point through the third and into early fourth quarter.

STEVEN CHAN: How about China?

MING LAU: China overall – China was also impacted by the compression in net interest margins. So year on year for the third quarter we saw about a 7% reduction on revenue for China overall.

EWEN STEVENSON: And, Ming, we also consolidate BoCom each quarter, but in arrears, so that had a meaningful reduction in the second quarter.

MING LAU: On profit, that would be feeding through overall for China, but having said that, I think, look, given the challenging environment, the balance sheet held up relatively well in China. I think there are signs of recovery overall in China, which should help us heading into the fourth quarter.

STEVEN CHAN: Thank you.

ROB NOBLE, DEUTSCHE BANK: Can I just clarify your GBM comment? When you said expect to normalise somewhere between 2019 and 2020 you're referring to Markets, not total GBM revenue, right?

EWEN STEVENSON: I would say on Markets, yes. There are certain parts of the business, like GLCM, that are obviously heavily impacted by the interest rate environment, so that should be, I would say, lower than it was in 2019. Securities Services continues to build for us. We're running down our Principal Investments business; that will reset to a very different level, because the only thing left in there will be a handful of holdings that we need to keep, like an investment in the Business Growth Fund in the UK. But yes, it was a comment about Global Markets.

ROB NOBLE: Okay. Great. And just on costs, could you walk us through 2021 – it sounds like you're expecting a fairly linear decline to your new guidance down to 2021 and loose guidance to 2022. Is that the right way to think about it?

EWEN STEVENSON: No, I think pre-results consensus was sitting in the mid-30s. I think we're comfortable with that. There's obviously a material benefit coming through next year from the bank levy. We've got the benefits of restructuring coming through offset by increasing amortisation costs from some of the technology investments we've been making over the last few years. We've got investments into things like growing out of our Asian Wealth platform. We've got investments going into our Asia wholesale platform. So we're broadly comfortable with where consensus was, which was mid-30s including the bank levy.

ROB NOBLE: Okay. And just specifically – how much has been saved from travel and entertainment and marketing from COVID this year? And presumably that rebounds next year?

EWEN STEVENSON: Within that there will be some post-COVID bounceback. So for example, we spent about $400 million on travel and entertainment in 2019. I don't know what that number is this year, but under $100 million. We think that in the medium term we'll be able to adjust the business model to be able to halve that number. We do think there'll be some modest snapback next year, but to below $200 million and, again, it's very much dependent on your assumptions on when does travel normalise and what part of the world.

Things like marketing spend – that was very depressed this year. There will be some snapback in that. Some of the sponsorship costs that we've got, because events weren't held this year, we've got some savings out of that. Printing costs have fallen to virtually zero at the moment. There'll be some snapback on that. We've mothballed various floors and various head offices. We're making savings on that, but there's probably – a bit of guesstimation here – probably $400-500 million of snapback in costs next year. We would expect to pay a bit higher in variable pay within that too, but that's all within the guidance that we gave earlier.

ROB NOBLE: That was my last question. You're happy you're seeing a normalisation in Markets and obviously take down variable comp on high Markets, so you're happy with lower Markets and a higher variable comp number?

EWEN STEVENSON: We've reduced accrual into our variable pay this year by I think it's around 30% so far, which is a very meaningful reduction in variable pay. We're just conscious of the fact from a planning point of view, if we've got a workforce in Asia with a snapback out of Asia – we do need to be paying market for talent wherever we operate in the world and we will have to adjust for that. Even if we were to accrue a higher variable pay pool, we still think that variable pay pool will be well below the levels of what we were paying in 2019.

ROB NOBLE: Right. Thanks very much.

ADRIAN CIGHI, CREDIT SUISSE: Hi there. Thank you very much. One follow-up question on costs please: as you very well described, there are potential pockets of cost reductions around various parts of the organisation, but at the same time you know that competition is increasingly coming from digital and automated players. In this context, how do you see the value from these lower costs split between shareholders and customers? To put it differently, are we in the world where we have to run fast to stand still in terms of returns, or is there any hope for us to see these costs leading to increasing returns? Thank you.

EWEN STEVENSON: I think the answer lies somewhere in the middle of those two extremes. I don't believe in the nirvana that margins don't shift and banks just continue to drive down costs over many years and shareholders accrue all the benefits. Equally, we do have to run. I don't say we have to run fast, but we do have to plan on the basis of year-on-year efficiency improvements to stand still. But on top of that, I do think there's material extra efficiency that we can drive out of the bank for the benefit of shareholders.

ADRIAN CIGHI: Okay. Thank you.

MANUS COSTELLO, AUTONOMOUS: I just wondered if you could give us a bit more detail, Ewen, on what you expect from the US in terms of the sanctions outlook. We had the report to Congress provided last month. I just wondered how you think that will play out, if you can give us some information about what's coming up from that. And specifically, how would you plan to deal with the specific individuals who are designated by the Department of State? Is it going to be possible to continue banking them or not? And just as a final question, do you think there's a risk of secondary sanctions on any other financial institutions in the region which could cause problems and how would you deal with that?

EWEN STEVENSON: I guess there's a lot of speculation in there, Manus, that we're not going to comment on. We're also not going to comment on whether any of the named individuals are customers of the bank, because it wouldn't be appropriate to do so, but we do think in aggregate we can manage comfortably for the imposition of sanctions as they're currently stated to be. So yeah, there's just not a lot that we're going to be able to say or want to say publicly on this because of customer confidentiality.

MANUS COSTELLO: Including on secondary sanctions? There's nothing you could say about how you might have to shift relationships with other financial institutions.

EWEN STEVENSON: Yeah, including secondary sanctions.

MANUS COSTELLO: Okay. Well, I tried anyway. Thanks.

MAGDALENA STOKLOSA, MORGAN STANLEY: I've got two questions, one about risk-weighted assets and another one on costs. Ewen, could you give us the context for the 3Q shrinkage in lending that you reported – that $14.2 billion – but not in terms of risk-weighted asset numbers, but in terms of the business context? Where did you shrink the business? Of course, it was between GBM and CMB. And how do you think about it going forward in terms of either portfolio or exposures? Where are those business risk-weighted assets cuts likely to come from? And also, going forward, of course, this will be a mixture of this plus some still optimisation in terms of models. So could you give us a context both of what happened in the third quarter, but also could you give us a context both of what happened in the third quarter but also your thoughts for the fourth and the 2021 as the numbers go bigger?

And lastly on cost, I'm just curious: did you have a much slower natural attrition this year? I assume you had, given what's going on. And how does this potentially affect your costs to achieve in 2021 and 2022? Thank you.

EWEN STEVENSON: On the natural attrition, it is running a bit lower than previous years, not unexpectedly, but equally hiring is a lot lower than it was in previous years, so I think the net of that doesn't really impact costs to achieve, because we just slow down hiring if we're seeing attrition levels being a lot lower.

In the third quarter – I guess a couple of things out of COVID. Underlying volume growth has been lower than what we would have anticipated and once we got through the spike in drawdowns that we saw in March of this year – a lot of that is increasingly getting repaid. I think corporates are sitting on very high cash reserves at the moment, which is impacting demand. We've got a lot of government funding schemes, which is impacting demand. So we are running at lower levels of new business growth than what we might have anticipated. We expect that to continue.

The other thing that's surprised us has just been the much slower rate of ratings deterioration than we might have anticipated six months ago and that's following through to much lower risk rating pressure from CRR migration. And again, as we sit today and as governments continue to extend schemes, I think that RWA migration will be slower than we anticipated. I think the other thing within that is the longer that time goes by, the more the corporates have had the ability to restructure, to adjust their business models, to raise equity and debt financing that we've seen in our Global Banking business in terms of high volumes, new issue volumes.

So sitting here today, I do think that probably Q4 RWA growth is going to be lower than what we would have anticipated even a couple of months ago, which is obviously positive in the short term for our common equity tier one ratio relative to what we may have expected and I think we've been surprised as the year has progressed at just the strength of the common equity tier one ratio, which has been driven by low RWA growth. We do think going into next year as Asia starts to recover out of COVID quicker that we will start to see the restoration of volume growth again. Richard, I don't know whether you want to follow up?

RICHARD O'CONNOR: We continue to plan for mid-single digit lending growth over the medium term. Going forward, as Ewen said, we expect it to be led by Asia through to spring next year. Q3 was obviously impacted by strong lending in Hong Kong IPOs, which is obviously continuing into Q4, but it may not continue forever. In terms of that volume – that volume of activity, clearly, we do expect a very strong pipeline of IPOs in Hong Kong going into 2021, so a couple of distortions actually in Q3, but let's stick to the 4-5% medium-term loan growth, which we have been flagging now for a while.

MAGDALENA STOKLOSA: Thank you.

RAUL SINHA, JP MORGAN: Just a couple. The tax rate point, can I just come back to that and ask you about a little bit more precision on the "lower 20s"? And the reason is that over the years as we model HSBC, moving to a global business modelling structure is helpful, but it loses the sensitivity to the regional tax rates, which we used to have in the subsidiary geography-based models. And one of the things that we are seeing is the profitability of the Hong Kong business coming down, which is also your lower tax jurisdiction. So I was just wondering how that has impacted your respective tax rate and if you could give us a little bit more precision about what we should think about maybe in 2021, 2022.

And then the second one is on BoCom. We've discussed this issue quite a few times, but it remains quite relevant, if you are looking to analyse the group's dividend pay-out ratio in terms of cash earnings. My question is - is the accounting approach on BoCom sensitive in any way at all to the dividends declared by BoCom? I've looked at your disclosures on it and I've struggled a little bit with that. So if you could give us any more clarity on that, that would be helpful. Thank you.

EWEN STEVENSON: On tax, Richard, I may get you to jump on, but on BoCom we do a value-in-use calculation, a DCF model of BoCom. It's not driven by the dividend payments per se, but it will be driven by what we think is sustainable cashflow out of the BoCom investment over the medium term. Nothing's changed there, but obviously there is a significant gap between market value and where it's held on our books. But just as a reminder in terms of the amount of capital that we hold against the investment, it's materially less than carrying value.

RICHARD O'CONNOR: As Ewen said, any dividend comes off their market value and indeed their book value. The value-in-use is a forward-looking tool. On the tax rate, most of you do adjusted EPS, excluding significant items such as costs to achieve, and goodwill and software write-offs – that effective tax rate remains about 20%. Within that, 21% is Hong Kong's and obviously it's rather costly, but that's a bit of spurious accuracy, but I think it's around something like 20 – maybe just over – tax rate on what you guys would call adjusted earnings.

FAHED KUNWAR, REDBURN: A couple of questions. The first one is on margin outlook. So I appreciate the rates impact – it feels like it's filtered through now towards Q4 and 2021, but looking at Hong Kong in particular, liquidity is getting increasingly abundant and growth is coming back. And the last time we had this situation, the competitive dynamic increased meaningfully and margins kept coming down. So I appreciate the scale of change in the margins will moderate, but how is the competitive element there and should we expect margins to keep on drifting down as local competition hots up or is there a reason why margins are stable, both from a rates point of view, but also from a competitor point of view?

And on the cost base, you talk about future of gross cost saves. Historically, the gross to net basis has been quite different, so you've got gross cost saves that are mainly offset by investments. So on future gross cost saves, should we expect a net cost result meaningfully closer to the gross cost cuts or will a lot of the gross cost saves be invested, as they have been before? Thanks.

EWEN STEVENSON: I'll get Ming to talk about the competitive environment in Hong Kong, but on the second, you're right that if you go way, way back we like to talk about gross cost savings that resulted in minimal net savings and that's why we very deliberately went out with a net cost target for 2022, and we're continuing to benchmark ourselves against that net cost target. There is natural underlying cost inflation in the business, but I am very focused on what the net of those two numbers is, rather than the gross cost savings that we're taking out of the business. What we're trying to achieve is a multi-year reduction in the nominal cost base of the bank.

FAHED KUNWAR: Thank you.

EWEN STEVENSON: Ming - on the competitive environment?

MING LAU: Clearly, the increase in liquidity in the market now, in Hong Kong, is impacting loan pricing. But I think, in terms of what we're seeing, and given the credit environment, it's largely at the top end of corporates. So we've already been seeing some of that impact work its way through the portfolio at this point. But again, I think given the credit environment we're in, it's been quite selective at the very top end of large corporates and multi-nationals. I think when you're thinking about margins for Hong Kong, you have to look both sides of the balance sheet. On the liability side, both in terms of absolute rates being paid on time deposits, plus the mix of time deposits, both those factors are playing a bit more favourably in terms of helping to cushion the pressure on the asset side of the business.

FAHED KUNWAR: Just to follow up on that, there is a lot of pro-cyclical pricing happening at the moment, in the UK, for example, and probably in Hong Kong. But as things moderate, do you think that asset spread pressure, and as growth comes back and that asset pressure picks up to the whole tiering of corporates, not simply high-end, and is there enough liability to offset if your asset spread compression got wider and affected more corporates than just the top end? Thanks.

MING LAU: Credit spreads today are pretty low and narrow. At this point, I think it's quite unpredictable in terms of where that is going to play out overall for Hong Kong.

FAHED KUNWAR: Okay. Thanks very much.

GARY GREENWOOD, SHORE CAPITAL: Hi, thanks for taking my questions. A similar vein to Fahed's question, about the gross versus net, but more in terms of the implication on risk-weighted assets. You're looking at a greater than $100 billion reduction now on the gross side, so I was wondering if that therefore implies there will be increased reinvestment into the business or whether you just think that's just going to free up more capital further down the line?

Then the second one's really a bigger picture question on the strategy and where you're going. It feels to me like the business is very slowly unwinding to where it was maybe 30 years ago. And I was wondering whether the Board had a conversation around whether you should accelerate that further, in terms of a break-up of the business, so potentially closing the US and freeing up capital, spinning off the UK ring-fenced bank and just focusing more on the Asian businesses, which is where you seem to be heading anyway? Thanks.

EWEN STEVENSON: So in terms of the second question, I wouldn't say 30 years ago, given that we only invested in the US, I think, substantially 20 years ago. But there's very a simplistic analysis that I think gets trotted out about breaking the Group up, but I think we derive a lot of value from the interconnectivity of the global Group. We're the largest trade bank in the world. I think what we're trying to do is to get back to the core value creation that's coming out of that international network, which is resulting, and will result, in a significant restructuring in the US and the non-ring-fenced bank in particular; we've been pretty open about. We've got no plans to fully exit the US. It would destroy a lot of value if we did that. We're the third or fourth-biggest clearer of US dollars in the world; we need to have a meaningful presence in the US. Having said that, we need to improve the profitability of the retail banking operations in the US, so we will continue to be focused on how do we do that.

There are very good reasons why we are headquartered in the UK. We had a good look at domicile about four or five years ago. There were very good economic reasons why it made sense to be domiciled in the UK. I don't think any of that has fundamentally changed. If we are going to be in the UK we want to retain a meaningful presence in the UK, to be relevant in the country, and you should expect us to continue to own the ring-fenced bank.

But going back to the rest of it, we've been very public that we're not happy with the returns that we're getting out of the US operation of the non-ring-fenced bank. We committed, in February, to very significant restructuring to both businesses to substantially reduce the capital allocated to both businesses. The $100 billion of gross RWA reductions is predominantly out of those two franchises, and we do think that we will see meaningful RWA growth in Asia that we can redeploy. If we can't we will return it to shareholders, either in the form of dividends or buy-backs.

GARY GREENWOOD: Okay, that's wonderful. Thank you very much.

EWEN STEVENSON: Okay. Well, thanks a lot, everyone, for joining today. I appreciate the time. I'm sorry we ran a few minutes over time. If you've got any follow-up questions, please go back to Richard and the IR team, and we'll try and answer your questions. But thanks again for getting on the call today.

RICHARD O'CONNOR: Thanks everyone.