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Transcript

Fixed Income Call
Q4 2020 Results

23 February 2021, 14.00 GMT

EWEN STEVENSON, GROUP CHIEF FINANCIAL OFFICER: Thank you and good morning or afternoon, all. It's Ewen here, the Group Chief Financial Officer. I'm joined today by Iain MacKinnon, our Group Treasurer, and Greg Case, our Head of Fixed Income Investor Relations. Given COVID-19, we're all actually in separate locations, so please bear with us if we talk over each other during Q&A. There's a Fixed Income-specific slide deck that's available on our Investor Relations website. We don't plan to speak to those slides in our introductory comments, and we'll try to keep our comments brief, as I know a bunch of you will have already listened to various things, including our equity call this morning UK time. I'll quickly run through what we've announced today; then I'll hand over to Iain for more detail on capital and funding before we open up for Q&A.

Today, as you're aware, we announced our full-year 2020 results, together with a business update with a refreshed strategy and some new financial targets, including a new dividend policy. For the full-year 2020 results, I'd describe them as a solid set of results, particularly against the backdrop of COVID-19 and a now ultra-low interest-rate environment. Adjusted pre-tax profits of $12.1 billion, reported pre-tax profits of $8.8 billion. Our core capital base strengthened nicely with year-end core tier 1 of 15.9%. That's up 30 basis points in the fourth quarter and 120 basis points over the full year. And deposits grew over $170 billion on a constant-currency basis, a growth rate of 12%.

Relative to the plan that we announced in February last year, the three-year target to achieve $100 billion of gross risk-weighted asset saves in targets areas, we delivered over half of that in the first year of the programme, which we're very pleased about. On operating costs, we reduced those by $1.1 billion or 3% in 2020, and we committed today to achieve a further $1 billion of savings by 2022 relative to our previous targets. However, the impact of the ultra-low rate environment means that we no longer expect to hit our 10% to 12% return on tangible equity target in 2022. We've reset that target to at least 10% over the medium term, which we've described as three to four years, and that's premised on a similar rate environment to what we see in the market today. Underpinning this is a much stronger set of growth aspirations for us in Asia both in wealth and in wholesale banking, with a target of increasing our capital allocated to Asia from 42% currently to over 50% over the coming years.

On the fourth quarter, again a decent set of results. Reported pre-tax profits of $1.4 billion. Adjusted revenues were down 14% on last year's fourth quarter, which was mainly driven by the progressive impact of ultra-low interest rates. Operating expenses were up 1% ex the bank levy, but this was mainly due to an increase in the variable pay accrual in the quarter, with the variable pay pool for the full year down 17% on 2019. Expected credit losses were $1.2 billion in the quarter, bringing total expected credit losses for the full year to $8.8 billion, and that's at the lower end of the targeted $8 billion to $13 billion range we announced earlier in the year. While we do remain cautious on the outlook for credit for 2021, we still expect the ECL charge to be lower than 2020. We've no update to the guidance that we gave on this at the third quarter, which was broadly a range of 40-60 basis points for the full year. By 2022, we expect ECLs to have fallen materially from the 81 basis-point charge we had last year towards or even below the lower end of our 30-40 basis point normalised range.

With that, I'll pass over to Iain.

IAIN MACKINNON: Thanks, Ewen. Hi, everyone. Iain Mackinnon here – thanks for dialling in. I'll just continue with the script. Despite the weak macro environment, balance sheet metrics continue to show strength. Our CET1 ratio is up 30 basis points in the fourth quarter to 15.9%. The 15 cents per share dividend announced today has impacted the ratio by around 40 basis points. During 2020, customer deposits grew by over $200 billion and loan balances remain broadly flat, resulting in a loan-to-deposit ratio of 63.2% down by 8.8 percentage points since the start of the year.

The Group remains very liquid, with gross high-quality liquid assets of $850 billion to hand. Despite this, our consolidated liquidity coverage ratio was down 11 percentage points at 139% for 2020, largely reflecting technical consolidation adjustments in the calculation of the consolidation, rather than an increase in liquidity risk. Note that this may decline further as we implement further regulatory adjustments, but the decline will have no material implications for the Group's overall liquidity risk management.

On issuance, I'm pleased with what we achieved in 2020. During the year we took a lot of action to reduce our refinancing risk in '21 and '22 while delivering negative net issuance. By tendering for nearly $12 billion of MREL in 2020, we've reduced this year's refinancing requirements from $12 billion to less than $6 billion and next year's from $15 billion to less than $11 billion. Looking out over this year, we expect to issue around $15 billion of MREL against maturities and calls of nearly $6 billion. The difference is the fact that this year marks the final year of material increases in the amount of senior HoldCo debt needed to meet regulatory requirements. From 2022 onwards, we expect to balance the senior HoldCo debt to follow the progression of the Group's RWAs. For AT1, we probably expect to refinance the instruments that we choose to redeem or where they lose capital eligibility. This is in line with what we did in 2020, where we redeemed nearly $2 billion of bonds and issued $1.5 billion in return. For tier 2, we have no plans to issue in 2021. On IBOR, our guiding principle is to work with bondholders to transition where we can, and we look forward to bringing forward transition offerings this year. With that, I'll hand back to Ewen.

EWEN STEVENSON: Thanks, Iain. Look, before we open up Q&A, I did want to take this opportunity, with all of you on the call, actually to say many thanks to Iain. It's actually his last Fixed Income call for us as Group Treasurer. Iain's retiring over the next month or so after many years with us both in Tax and Treasury. On the next of these calls, we'll have our new Group Treasurer. He'll be known to a number of you, Carlo Pellerani, who was the recent Group Treasurer of UBS. Carlo starts on Monday.

With that, if we could now open up for questions.

PAUL FENNER-LEITAO, SOCIÉTÉ GÉNÉRALE: Hi. Good afternoon, gentlemen. Iain, congratulations and best of luck for the future. I've really just got, I guess, two connected questions. On stage 2 – and forgive me if this came up this morning; I may have missed it – obviously stage 2 exposures has ticked up again in the fourth quarter, not by much but by something. It's basically doubled during the year, but I think I'm right in saying that the stage 2 element that is past due has not changed at all during the year. So I was just trying to understand what's happening there between the relationship between stage 2 that is still paying and those that are not paying. Is there a connection and, if there is, what is it? And what might we expect from stage 2 balances during the course of 2021?

Leading on to my next question, where do you see, for stage 3, I hear what you're saying about cost of risk, but, if we think about an NPL ratio, a stage 3 ratio, do you think it peaks in 2021? And how far from the peak are we right now? Thank you. Sorry about the longwinded question.

RICHARD O'CONNOR, GLOBAL HEAD, INVESTOR RELATIONS: It's Richard O'Connor here. I'll start and, Greg, if you maybe chip in. Look, stage 2, it's primarily due to the forward economic guidance and those calculations and indeed overlays, and obviously when we did the year-end, then, clearly, even in the last few weeks, maybe the economic outlook improved a little bit due to the vaccines, but clearly there was still some deterioration, for example, in the UK, and you're right to say that we had a remarkably low level of default throughout the year. We've obviously had some hits.

In terms of stage 3, while we don't want to get drawn too much on specific forecasts, clearly stage 3 defaults in some cases are a lagging indicator, and certainly, as government schemes mature this year, you may see a pick-up in stage 3 from some of those elements – hopefully not. And then, if forward economic guidance improves during the year, you may see them moving back from stage 2 to stage 1. So I think there are a lot of moving parts there, but, broadly, as you've heard from Ewen today, our overall expectation for the charge this year remains in the 40-60 basis points of loans, and that's been unchanged since the Q3 stage. So you've seen the stabilisation in the last few months, and indeed some better macro trends in the last few weeks. Greg, anything to add to that?

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: Yeah, just on the stage 2 side, it's worth noting that about a quarter of our corporate loans in stage 2 right now are within the risk grade that we would classify as effectively investment grade. And, obviously, with those types of exposures that are relatively low PDs, it doesn't take a particularly big shift for the PD to degrade to such an extent that it falls into stage 2, and then, obviously, while there have been a significant number of downgrades across the portfolio, it's worth noting that there have been some upgrades, and that has been reflected in the numbers somewhat.

LEE STREET, CITIGROUP: Hello. Good afternoon, all. Thanks for doing the call. Three questions from me, firstly on stage 2 as well. Now, in the Fixed Income slide deck you've got that chart on page 11 that shows the strong or good-quality credit. Obviously, that's gone from 75% of the book down to 70.3% over the year, but stage 2 loans have increased by a bigger proportion from 7.7% to 15.5%. So is it right to compare those things together? I suppose my question is, given the move in stage 2 loans, shouldn't we have seen a greater reduction in the strong or good-quality credit? That'd be my first one.

Secondly, obviously it's an 'if', but, if you sell the French retail operations and you sell the US retail operations, would that be sufficient to alter your funding plans in terms of holding company senior debt for the year, given the reduction in risk-weighted assets that might entail? Finally, on the Bank of England legacy capital review, you refer to determining whether any action is required. In terms of making that determination, is it a question of how you interpret the Capital Requirements Regulation or is it a question of materiality, i.e. how much of the relevant type of debt you have outstanding? They'd be my three questions. Thank you.

EWEN STEVENSON: Richard, you can take the first one, I'll take the second one and maybe Greg can take the third.

RICHARD O'CONNOR: Not much to add to stage 2; you're right to say that clearly the strong or good has gone down in the areas we've shown on our chart. There's another chart in the deck – sorry, we've got a lot of graphs here – which showed it's more on credit-rating migration, but there was a bit more of a stabilisation across the grades in Q4, albeit clearly we had some stage 3 hits in Q4 as well.

So, look, the other thing I would say is clearly you're right to point out the stage 2 movements for us. What I would say is we do use more scenarios than other banks, particularly in Europe. So sometimes you just need to go through all our workings, and that can obviously give you a slightly different picture to other banks, which may use slightly fewer or different scenarios in their IFRS 9 modelling.

EWEN STEVENSON: On the question of French and US retail, without confirming whether or not we will sell them, but if we were to sell them, I don't think that would change our issuance plans. They're not big enough to have any material impact. Greg, do you want to take the third question on the legacy capital instruments?

GREG CASE: Yeah, of course. So, on the legacy piece, the wording we used in that slide was effectively to mirror the wording that the 'Dear CFO' letter used. It's not necessarily pointing towards the fact that we think there may be any actions to be taken at this stage. I think it's too early to say, but, as you've heard from some of our UK peers over the last week or so, we're busy looking over the various bonds that we have. As you know, we've got a relatively small amount of bonds that are grandfathered for 2021, and we're going to share the analysis with the PRA and have a discussion from then on.

LEE STREET: All right, and is it an interpretation of the rules or materiality, or is it both?

GREG CASE: I think that's still for discussion.

LEE STREET: Alright. Thank you very much.

DANIEL DAVID, AUTONOMOUS: Hey, good afternoon and thanks for the call. Just a quick one, hopefully, on legacy capital. I just wanted to touch on your OpCo tier 2. So although they might not cause an infection risk, I suppose they could be deemed an impediment to resolution, so my question is, do you expect the PRA to consider other factors such as retail holdings or non-resolution entity impediments as part of the process that is going on here?

And, secondly, just on ESG, noting your issuance in the past, is there a percentage of your issuance plan this year that we should think of that will be targeting green formats? And, more broadly, the EC taxonomy is kind of a positive step, I guess, to improving ESG disclosure, so can you comment on how this factors into the broader ESG strategy at HSBC? Thanks.

EWEN STEVENSON: Greg, do you want to start off on the legacy question and then start on the ESG question?

GREG CASE: Yeah, sure, of course. On the OpCo tier 2, I think, again, it's still a discussion with the PRA over the course of this year, be it either as part of the 'Dear CFO' letter and what comes out of that during the course of the next month or so, but also as part of the resolution assessment framework that obviously was pushed back by 12 months but of course is very much an agenda item for us for this year. At this stage, as I say, there's not a huge amount to say on the subject. Obviously, from an impediment to resolution perspective, we can have a view on that and we take that to the PRA and have a discussion, but it's going to have to be a two-sided discussion and we wouldn't want to prejudge that.

Just to touch on green bonds, we have, as you can imagine, a portfolio of green assets that we can put against things like green bonds. In recent years, we've been prioritising some client business that is backed by green collateral, so we have a number of client facilities like a green CD programme, green structured notes, but for this year we would very much like to come to market with a benchmark green deal. It has been a year or so since we've last been to the market.

DANIEL DAVID: Great. And, just on the EC taxonomy, I guess many market participants see it as quite a big step forward in terms of improving disclosure, so I was just wondering more broadly if you're observing it and if you're factoring it in to the way you're progressing as an ESG-aligned bank?

RICHARD O'CONNOR: I'm not 100% sure I understand the question, but, clearly, as an ESG bank, we're looking at a variety of frameworks, and the one we're looking at particularly is the WEF framework, the World Economic Forum. Clearly, we've been a leader in TCFD disclosures, and we've made substantial disclosures today in the ESG report, in the TCFD report and in the new ESG data pack. So, clearly, we're working hard with all the relevant providers, but I think the one we're moving forward with more generally on disclosures is the WEF Framework. I'm not sure if that answers the question, but that's how we're currently thinking about it.

DANIEL DAVID: Okay, thank you very much.

ALVARO RUIZ DE ALDA, MORGAN STANLEY: Thank you very much for taking my call. I have three questions. The first question is regarding the DISCOs. Should we think differently about the securities that are issued from the Hong Kong subsidiary as the LCR from this entity is quite high and the security will not be MREL-liable after January '22? My second question is a broader question, it's regarding any impact because of the movement to Hong Kong in terms of the regulatory environment. And my third question is regarding ratings. Do you guys have any comments or thoughts about Moody's or Fitch's downgrades?

EWEN STEVENSON: Greg, do you want to take the first and third and then I'll pick up the second one?

GREG CASE: Yes, of course. Yes, to an extent you should think about the Hong Kong and the UK DISCOs separately. They are issued by two different banks with different regulatory regimes and obviously, as you note, different liquidity positions. Now, I'm not saying that we're necessarily going to look at them differently or that one is more likely to be looked at as something to take out in the future or not, but I think it is worth bearing in mind that they are under two very different regulatory regimes. So I think that's important to note.

On the ratings side of things, look, I think we're broadly comfortable with the ratings that we have. Obviously, we'd always like them to be higher. There's not really much we can add beyond, I think, what the various ratings agencies have said publicly on the subject at this stage, and obviously if you want to engage with them directly, you can feel free, but we're not going to put words in their mouths.

EWEN STEVENSON: Yeah, on the regulation point you may need to clarify the question, but there's nothing behind what we've announced today or Noel's comments around considering moving some members of his senior management team to Hong Kong that's driven at all by regulation. We are very much domiciled here in the UK. Noel and I, for the foreseeable future, are based here in the UK, and there's nothing in today's announcement that's driven by either a pushback from the PRA or a pull factor from the HKMA.

ALVARO RUIZ DE ALDA: Okay, that's great. Thank you very much.

TOM JENKINS, JEFFERIES: Hello. Thank you very much and hello, everybody. I'm going to throw Greg under the bus one more time on DISCOs, but it's an easy one, I hope, and then I've got a couple of questions on the asset sales, if I may.

Firstly, on the legacies, if, like me, you're basically home schooling several inpatient and petulant traders, then 31 March has become quite a big date in the calendar for the PRA review submissions. What sort of communication do you think – I'm probably asking this a bit early, but do you have any plans to communicate to the market what your submissions either look like or rough ideas, or are you going to wait until the latter discussions with the PRA are concluded? And, if that's the case, what sort of timeframe – best guess, and I promise I'm not going to hold you to it, but what best guess would you put on that, before there's a market communique?

And then, secondly, the asset sales, I really want to look at the US. I'm just wondering what package you're looking to sell. Is it just HSBC Bank USA NA, the bulk of the retail business, or is it the intermediate HoldCo that sits above that, HSBC USA Inc as a package, or are you pretty much open to selling parcels of loans if that's all you can get a bid for? And I guess the same thing goes for France, really. Maybe looking more at the liabilities side, seeing, as I understand, that you've already separated retail from commercial lending to a large extent there, is it your anticipation at this stage that the package you're looking to sell in France would include CCF bonds or not? Those would be my questions. Thank you.

EWEN STEVENSON: Yeah, so Greg can pick up the DISCO question and then I can pick up the M&A questions.

GREG CASE: Yeah, of course. Generally speaking across the piece, obviously the 31 March deadline is the deadline for us to submit our initial analysis and thoughts. How long that conversation goes on – very, very hard for us to guide on. I think it will be a function of many things, and obviously many different priorities, so I'm afraid I'm going to have to disappoint you there, Tom, and not give you a specific –

TOM JENKINS: Again.

GREG CASE: On the market disclosure and things like that, look, it really depends on whether or not there's anything to tell you. That's kind of the first point. If there is something to tell you, then of course we're very conscious that there may be price-sensitive information in the mix here, and if we need to make a disclosure we'll make a disclosure, but we're not planning at this stage a wholesale disclosure piece, to be quite honest with you. It's more around if we do become party to anything, we'll say something.

TOM JENKINS: Right, okay. I figured as much; I just wanted to check.

EWEN STEVENSON: Yeah, and I'm obviously somewhat constrained, Tom, in what I can say about the M&A processes, but I think, if M&A processes do eventuate, there'll be parts – France won't include the bonds and the US wouldn't be a legal entity.

TOM JENKINS: It would not be a legal entity. Sorry, did I catch that? I was just cracking up a bit there. Did you say –

RICHARD O'CONNOR: If that theoretical event were to happen.

TOM JENKINS: Yeah, sure, sure. Okay, interesting. Thank you very much.

ROBERT SMALLEY, UBS: Hi, thanks very much for taking my questions and good luck, Iain, and, Greg, thanks very much for the package that you send every quarter. It's very helpful. Two topics – one… And I guess they're both kind of following on from Tom. In the call earlier this morning, the idea of trapped capital in the US was brought up. How much capital is trapped in the US? How would you plan on getting it out? Are there tax implications to that? And what's changed? Because I imagine that you've wanted to get some of this out for a while.

And, I guess, secondly, if you could just follow up on the comment you just made on legal entity/non-legal entity. The call broke up and I'm not really sure what you were referring to. Thanks.

EWEN STEVENSON: Well, on the second question, I think the question was, 'Are we contemplating selling a legal entity in the US?' and the answer is no.

On trapped capital, this has been an issue that has persisted for a number of years and, today the order of magnitude is probably something in the order of about $5 billion of capital. You don't see it at the Group level, because effectively we take on additional double leverage. What we'd like to do is pay the capital out and pay the double leverage down. Yeah, we think it will be a three, four-year journey for us of restructuring the US business and getting the regulators comfortable that we've got a sustainably profitable business in the US, and then through several CCAR cycles effectively getting approval to pay that capital up to the Group.

RICHARD O'CONNOR: And there are no tax implications of that. That's normal dividend upstreaming.

ROBERT SMALLEY: That makes sense. Thank you.

JAMES HYDE, PGIM: Hi, Ewen. Hi, everyone. My question is a slightly philosophical one about where you're going, especially for us, with the developed-market investment portfolios that my company runs. Now, 42% tangible equity invested in Asia goes to 50%. Kind of why stop at 50% given the ROE differential? Is that the sort of stop that then makes you have to revisit domicile or is this to do with balance for ratings agencies? I just want to understand the thinking of any such benchmark. That's the first question.

EWEN STEVENSON: I guess it was driven by a realistic medium-to-longer term target of shifting of capital. I mean, when you do the maths on it, it's a fairly material reallocation of capital from west to east over that period. I wouldn't fixate on 50%, but we are a global business today, and a lot of the value in Asia is driven by that global connectivity out of customers in the US, Europe and the UK, and therefore there will always, I think, for the foreseeable future, be material amounts of capital invested outside of Asia to support and self-reinforcing with the Asian business.

RICHARD O'CONNOR: And, Jim, the timeframe here was three, four, five years, depending on which particular target, and so clearly as we go through that time period we'll roll forward our plans to suit on the opportunities we see at those particular times. It's very much meant to be a pathway for the next few years.

JAMES HYDE: Thanks, Ewen. Thanks, Richard. Just another question on these proposals regarding ESG – or particularly the climate concerns that you're going to put to the AGM – I just want to understand, can you give us some colour on what's going to change? Is it going to be a formal refusal to do any more coal anywhere or any other fossil fuels? I just want to understand what would satisfy some of the ESG shareholders that are being vocal?

RICHARD O'CONNOR: I'll take that. We've obviously received the ShareAction resolution, and indeed the resolution which was co-filed by other institutional and retail shareholders. We are in positive discussions with that group, and clearly we'll have to put out our AGM notice some time towards the end of March, and in any event there will be a climate resolution filed, but, clearly, as you saw with Barclays last year, there were actually two resolutions filed but ultimately a number of investors would prefer that there was just one resolution filed, so we're still in that process, Jim, so I'm afraid we can't be too specific.

But, as the CEO, Noel Quinn said today clearly there will be an element of a commitment to end the financing of coal during a certain period of time. Clearly, we'll also be making greater disclosures in terms of sectors and sector pathways towards the net-zero goal for 2050, but that's still very much a work in progress, and we can obviously update you as and when or before we file the AGM notice in a few weeks' time.

JAMES HYDE: Great, thank you very much.

DAN CROWE, GOLDMAN SACHS: Hi there. Thanks for the call. Just a quick one – my line broke up earlier, so it's more of a clarification on issuance and AT1. I assume that the refinancing includes both the $2 billion in AT1 coming and the $1.8 billion in legacy tier 1. And then a kind of follow-on from that, if the PRA asks you to remove some of the OpCo debt that is counted in your tier 2, would that change your issuance there?

And then I'm sure this was covered in the call earlier, but I had to drop off. I'm just trying to tie off a few numbers on your RWAs. I don't think I'm missing something in terms of increases for this year, so it just looks like you simply reach next year with pretty significant excess capital – I guess hence the talk of buy-backs – or is there something this year that I should take note of?

EWEN STEVENSON: Greg or Iain, do you want to take the first part of that question and then I'll pick up on RWAs?

IAIN MACKINNON: On the AT1, what we said was that we would continue with the pattern of replacing when appropriate. I don't really think we want to go beyond that. And then on the tier 2 we're not seeing any particularly vigorous action from the PRA beyond the conversations we're having with them on the legacy instruments. So I don't think there would be anything happening this year that would force us to change the issuance plans. I think that's where we are.

EWEN STEVENSON: And then on the RWAs on the equity call this morning, firstly we haven't guided as to capital ratios at the end of 2021. What I did say was the following. I mean, firstly, yeah, we are probably more bullish than consensus on loan growth, as you would expect us to be, but we are targeting mid single-digit loan growth over the next couple of years. We have about $10 billion of RWA uplift from regulatory pressures this year and probably a combined $40 billion to $50 billion over the period through 2023. We've got the RWA run-down programme; that's still ongoing. We did $52 billion in the first year; we've got another $30 billion to do this year, we think, and the remainder the year after. And then you'll have your own views on credit-rating migration, so there could be a degree of that this year. For conservative reasons, we'll assume that there is until there isn't.

So, yeah, I think you're right that some of the equity analysts had assumed that that led to significant capital surpluses. I did say this morning to the analyst sell side that we weren't planning any buy-backs on top of the dividends for this year.

DAN CROWE: Okay, but there's nothing beyond that that I should be taking – I mean, that's all stuff I had assumed. There's nothing coming out of the woodwork.

EWEN STEVENSON: No.

DAN CROWE: Okay, perfect. Thank you very much.

EWEN STEVENSON: Okay, well, look, thanks everyone for joining the call today. If you've got any follow-up questions, please follow up with Greg Case, who's been on the call, and your normal Investor Relations channels, but I greatly appreciate you taking the time to join the call today. Thank you.