HSBC

Transcript

Post Results Call
Q4 Analyst Meeting

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RICHARD O'CONNOR, GLOBAL HEAD OF INVESTOR RELATIONS: Good morning and good afternoon, everybody. Thanks for joining and for taking the time in what's been a busy week for everybody. On the call is Ewen, myself and the rest of the IR team, and Ming Lau, our CFO in Asia. With that, let's just go straight into the Q&A to help fill in any gaps which we left from Tuesday and go from there.

TOM RAYNER, NUMIS: I wondered, Ewen, if could you maybe just add some colour to your interest rate sensitivity tables? They're a permanent feature and obviously we always look at them, but I guess at the moment with what's happening in the markets it's going to become increasingly a focus. I'm just trying to get a sense – when I look at the one-year table on the bottom of page 179 you give the breakdown of the sensitivity in the different currency blocks. We don't know if that sensitivity remains constant in year two, year three. I assume it does. Similarly, with the parallel shifts, we're not really seeing parallel shifts; we're seeing quite sharp moves at five-year and not so much at the shorter end at the moment. I was just wondering if you could give us some feel for which bits of the curve –the fact that 10-year's going up in the US, does that matter at all if the two-year and five-year stayed the same? Any colour to make those tables more helpful to us would be appreciated.

EWEN STEVENSON, GROUP CHIEF FINANCIAL OFFICER: Richard, maybe you can jump in, but in the US, the steepening of the US curve at the long-end is helpful but is not that material to us. We're far more exposed to near-term movements. I understand, Tom, that the disclosure that we've given is probably less helpful in the context of what's going on at the moment. In Hong Kong it's definitely one-to-three month HIBOR is where most of the book reprices, so we're very sensitive to the very short end of the HIBOR curve. Equally in the UK, again, it's typically very focused towards the near-end.

On the loan side, if you think about it on the asset side, most of the Hong Kong book reprices within three months. Also, the trade book we've got in Commercial Banking is relatively short-dated too, so a feature of our interest rate sensitivity if you were to compare us to global peers is where we do see material rate shifts at the shorter end of the curves, it translates much more rapidly into our P&L than peers. The great bulk of the impact is within two years, and a meaningful impact within one year. Richard, what else?

RICHARD O'CONNOR: Tom, one of the components is that we show our bond portfolio by duration; you can see it's very, very short. As Ewen said, obviously there's not a long curve in Hong Kong so it's very, very short, related to short-term HIBOR, so that's the biggest sensitivity. As you would expect, in the UK we do the normal rolling five-year hedges on deposits and capital like the other banks. Same in the US and France, so – but the biggest reason why we're very, very short-dated is obviously the Hong Kong book. That's why you see us much more sensitive on the one-year versus others who are more sensitive on the two-to-five-year curve when you look at the sensitivities compared to other banks.

TOM RAYNER: Okay, thanks for that. I've always wondered why it's such a feature of the UK domestic banks, the structural hedging, and it's obviously something you do in the UK but this doesn't seem to be repeated necessarily in other markets, and that's mainly to do with the duration of the assets is it? And the nature of the assets more than anything else?

RICHARD O'CONNOR: It's due to Hong Kong mainly, Tom. It's a short-dated market and there's no long-term hedging in the Hong Kong market. That's the major difference between us and peers.

EWEN STEVENSON: If we tried to hedge long-term in the US we'd have to do it in US dollars and then we'd just be swapping interest rate risk for currency de-pegging risk.

TOM RAYNER: Okay, thank you for that.

AMAN RAKKAR, BARCLAYS: Hey Ewen, hey Richard. I had a quick question on the restructuring that's taking place, primarily in GBM. I was wondering if you could update us. I guess it wasn't a feature of the call the other day, but last year we talked about the revenue attrition that we expect from that GBM restructuring. I think – forgive me, my memory might fail me here – it was something like $2.5 billion of lost revenue near-term, and you're going to hope to reclaim a decent chunk of that in the outer years. Could you update us on that impact? Firstly, is that right? Secondly, I guess there's a lot of noise in GBM at the moment, not least because 2020 has had a strong year. If you could help us understand the impact of restructuring on that business that would be really helpful.

The second part to that question is just about your expectations for the Markets business this year. I think when we did this call at Q3 you told us to take the average of 2019 and 2020 as your best guess of 2021. Given what you can see of the world, it looks like Markets have had a decent start to 2021. Could you update us on your best expectations there, please?

EWEN STEVENSON: On the second part, I think somewhere between 2019 and 2020. If we looked at the start of the year I think January started off well, February slowed down a bit, but it doesn't feel like we're going to have a repeat of 2020 this year in the Markets business.

On the impact of the restructuring, I don't have to hand what was mentioned a year ago, but since we came out with those numbers obviously the whole activity levels in Global Banking and Markets, and it's not just Markets, it's also primary business in Global Banking has fundamentally shifted as well. I think you take the two statements together. We'll have done a lot of the restructuring of Global Banking and Markets by the end of this year, which is really shifting capital and capability out of the West to the East. I think we disclosed what our RWA rundown was in 2020 in Global Banking and Markets; remember, we also did a chunk in Q4 2019 as well, together with what we're going to do this year, and yet we're still expecting revenues this year in Global Banking and Markets to be higher than they were two years ago. When you look at it in aggregate, we think revenues are going to have gone up despite the restructuring.

RICHARD O'CONNOR: I'll add to two things to that. Firstly, we don't disagree with market estimates of overall industry revenues in the Markets business for this year being down about 10% or so, so that's clear. As Ewen said, as you've seen the RWA rundown we've done over half of what we intended to do in GBM. It needs to be a constant process of client recycling and recycling assets to Asia, and that'll be ongoing over a number of years. It's not a finite programme, it's an ongoing programme, but the GBM team did a very good job last year in getting the risk-weighted assets out, and we're confident they'll do the same this year.

AMAN RAKKAR: Thanks very much for that. Just a quite point of clarification, just to make sure I understood. Given you're hoping to do most of the reshaping of that business by the end of 2021, is it fair to think that there might be some incremental, underlying pressure from restructuring of GBM to manifest in 2022, or are you saying that actually you think it's basically going to be fine, and because of where you're redeploying the assets we're probably not going to notice it?

EWEN STEVENSON: I would say both. The bulk of the restructuring in the US has been done, will be done this year. A meaningful amount of the restructuring in Europe will have been done this year. The capabilities build-up in Asia will take more time, but the bulk of the repositioning of the business will have happened by the end of this year, I would have thought. Richard?

RICHARD O'CONNOR: Absolutely, but as I say, it'll be an ongoing process thereafter as well, because clearly it's by no means the finished article. As Ewen said, the investment in Asia will obviously start this year and continue this year but will be in an ongoing process over the next one-to-four years.

EWEN STEVENSON: I would say, look, fundamentally the industry – not us, the industry of which we're part – still has a pretty structural problem in Europe in terms of returns, which all of you would see in your own businesses as well, where the industry in aggregate is still struggling to get the cost of capital returns in wholesale banking in Europe, and we're part of that same dynamic. We try and target customers where we should have a right to win and embed a return being those who are looking to do business internationally into Asia, etc, but structurally European wholesale banking still has a returns problem.

EDWARD FIRTH, KBW: I wondered if you could update us a little bit on some of the political issues. I know it's obviously a sensitive issue so you've got to be careful what you say, but I guess the laws are up and running now. I guess you're implementing them in the way you own your business. I'd just be interesting to get a sense as to how that is affecting the business, any changes with the new administration in the US, and any colour on how those risks are progressing?

EWEN STEVENSON: Practically in terms of day-to-day running of the business it's not anything that's particularly material. Obviously laws change in every country around the world, and we have to adopt whatever the new law is. The National Security Law, as you all know, has resulted in us having to close what is no more than a couple of handfuls of accounts at this point. You can see it in the numbers that deposits in Hong Kong continue to go up, so you can't actually point in the numbers to a material impact. What we have seen is stuff like – again this is all in public data, and you can see, for example, that ultra-high-net-worth money has gone to Singapore, so non-domestic ultra-high-net-worth money has gone up in Singapore. We think some of that's coming from Hong Kong and some of that's coming directly from mainland China. We have a big private bank in Singapore. We think we are capturing most of the flow that's shifting out of Hong Kong to other parts of the world. But tangibly, in terms of the numbers, it's very hard to point to anything other than what we see going on at a macro level.

To the extent, for example, that expats are relocating out of Hong Kong to Singapore, what you see is Singapore real estate prices going up but Hong Kong prices staying broadly okay, because you've got an influx of mainland Chinese into Hong Kong to replace people who are leaving, so both property markets remain robust. I was talking to Peter Wong a couple of days ago. The Hong Kong economy at the moment – again, very difficult to see any impact. The financial markets are doing very, very well. The main impact on the Hong Kong economy is driven by coronavirus and the continued closure of the Hong Kong/mainland China border, so that, together with the implications of low HIBOR are two things we pay far more attention to at the moment in terms of the impact on the business.

On the US administration change, some of the public rhetoric may have changed but I think the broad dynamic between US and China probably hasn't fundamentally shifted as a result of the administration change, so some of the emphasis may have changed in terms of a focus from the Democrats more on human rights, but we're not assuming anything has fundamentally changed as a result of the administration change.

EDWARD FIRTH: Okay, thanks very much.

MANUS COSTELLO, AUTONOMOUS: Good morning, everybody. I had a question about RWAs, please. You mentioned that you saw $30 billion of RWA migration in 2020, and you were saying you expect to see more in 2021. My question is: how do we square that migration with what you've given on the ECL guidance? What's the process for seeing credit migration going in one direction in RWAs but going in the other direction in the P&L? Ultimately, I guess what I'm asking is: isn't the expectation of further migration in 2021 too conservative, and won't, in fact, you see some of that $30 billion reverse? And if that's the case, if I then put together your regulatory inflation, minus the gross cost saves that you've still got to go, you could end up with flattish RWAs for the next couple of years. Is that too bullish an assumption?

EWEN STEVENSON: Yes. I don't think it's inconsistent with IFRS 9 reserve build-up and modelling multiple scenarios and putting probabilities against those scenarios that we could still expect some ratings migration. The thing at the moment, Manus, that I guess we're sensitive to is just the unprecedented level of government and central bank intervention we've seen in the global economy, and that continuing governmental support we see to the underlying economy. And at some point that support has to taper and wind off, and trying to second guess

what the impact will be on those economies when it does wind off. Are you going to see delayed ratings migration that otherwise would have occurred earlier, absent government support?

Against that, obviously the longer time progresses the more time that people have had to adjust their business models, adjust their personal spending, adjust the financing of their businesses, etc. We had anticipated a higher ratings migration than we saw in 2020. On the back of that we reduced the amount of ratings migration we expected in 2021, but in terms of the RWA modelling and the various inputs into that, being loan growth, regulatory change, the RWA rundown programme and CRR migration. Probably CRR migration to me feels like it's got the biggest delta around it currently in terms of our own forecasting.

In terms of your flat RWA number, remember, we did talk about meaningful regulatory uplift in RWAs coming over the next one, two, three years. We expect say $10 billion this year and a further $30 to 40 billion over the next two years. We've told you that we've got about $50 billion of RWA rundown to happen, so those two largely offset each other. You've got CRR migration in the middle of that. I guess to get to what you've just said you would have to assume a massive reversal, and we've told you that we are expecting mid-single-digit loan growth. If you factor in that mid-single-digit loan growth then the only variable you're playing around with is CRR migration. And as I said, I think that has the biggest delta around it. Richard, anything else?

RICHARD O'CONNOR: I think what we're guiding to broadly is mid-single digit loan growth and low-single-digit RWA growth, but clearly, as you know, there's obviously a big delta around that, as Ewen said. Obviously we'll record each quarter how we get on during the year.

MANUS COSTELLO: That's very useful colour. Thank you, guys.

MARTIN LEITGEB, GOLDMAN SACHS: Good morning. Two questions from my side. The first one: I was just wondering if you could update us on the progress HSBC has made in addressing capital inefficiencies. I think those capital inefficiencies were in the non-ring-fenced bank, so it was HSBC Bank plc, but I think there were some capital inefficiencies elsewhere within the Group. Just looking at the subsidiary accounts, it seems like the balance sheet hasn't shrunk by a large degree at this stage, I guess some of the derivative position has moved. I was just trying to get a sense where these inefficiencies have come in the meantime and in particular also the Principal Investments book there. The reason for the question is I was just trying to get a sense for the timing, how long will it take HSBC to get to the target range of 14 to 14.5% common equity tier 1?

The second question is I was just wondering if you could comment on your growth ambitions in the UK now that Brexit is done. I think last year there was a bit more of a cautious tone in terms of the risk inherent in the UK, just given the strong deposit growth at HSBC UK Bank had through the year, should we assume a more ambitious growth plan? Thank you.

EWEN STEVENSON: On capital inefficiencies, as you step round the Group, the US today probably has, we think, about $5 billion more capital than we think we need in it, plus or minus. But we think it'll take us three to four years to optimise that, because in order to get that capital out progressively we need to demonstrate that the restructuring of the US business is getting to a place where it's achieving decent returns to get the US regulator's comfort to allow that capital to come out over progressive rounds of CCAR. Just model that out over a three to four year period. Then in a way, I think that's why we're probably – in part, all of these comments go to a degree of conservatism and our views on capital more than is currently being modelled by the street.

Secondly, the non-ring-fenced bank is a different set of issues. It's more – historically, what we've had in the non-ring-fenced bank is high levels of peak-to-trough stress, and we think that restructuring will progressively aggressively address that. It isn't really a trapped capital issue in the non-ring-fenced bank, because from a regulatory perspective the non-ring-fenced bank is regulated by the PRA. The PRA doesn't need to impose on us high capital requirements and track capital in the non-ring-fenced bank, because they view capital as largely fungible from Holdings into the non-ring-fenced bank whenever we need to do it. You would have seen, for example, last year one of the reasons for running down the Principal Investments business in Global Banking and Markets was because it had a very high stress component about it, and a lot of the customer exits we're doing in Europe too is getting to that high stress component.

The other thing is Asia, and again, what you see in Asia are various things. If you look at, for example, where Hang Seng's common tier 1 ratio is, it's much higher than the Group common equity tier 1 ratio. That's a structural issue and discussion we need to pick up with Hang Seng as to the need for that level of capital sitting within Hang Seng. There are some subsidiaries in Asia where we're working on putting more Tier 1, Tier 2 capital into them in order that we can optimise more the equity base. Again, each of them is an individual conversation with each regulator, but it's probably a three-to-four year journey to get that optimised over time. Today there's probably over $10 billion of trapped capital in various subsidiaries around the Group, but the timeframe for getting that back up to Group is probably three to four years.

On the UK, we showed last year that we continued our growth aspirations in the UK. The UK ring-fenced bank is very much core to how we think about the world. We have got a lot of excess liquidity; last year in mortgages I think our flow share was around 10%, comfortably about our stock share, which has now grown above 7%. We continue to have aspirations to grow the mortgage book healthily. I think in all of the government lending schemes we did an excellent job at taking – if you look at the Bounce Back Loans our market share was comfortably above our Business Banking market share, and also Brexit, I think, will be positive for us because you've got a whole bunch of UK corporates who are going to realign their business models internationally. We are the best domestic bank placed to do that for them, because we're the only UK bank that's got a joined-up domestic bank and international network. Our aspiration is to continue to grow the UK ring-fenced bank ahead of peers in the same way we have for the last few years.

RICHARD O'CONNOR: I just had a couple of things. You'll see we grew our market share in mortgages yet again, over 10% new business share, so just over 7% stock share, grew the Commercial Banking share to about 50 bps, so over 10%. We were quite quiet in account openings over this last year; we were focused on serving our existing customers during Covid. That'll change this year, and you'll hear a lot more about first direct and a lot more about digital and innovation this year as we go on the offensive. We'll talk more about the UK during 2021 and 2022 than we did at the results presentation earlier this week.

MARTIN LEITGEB: Thank you very much.

MAGDALENA STOKLOSA, MORGAN STANLEY: Hello, thank you very much for taking my questions. I've got two, a little bit more strategically. The first one is on Wealth, because of course we've heard more about it at the quarterly presentation. But Ewen, could you put more in context for us, more business-wise, when you talk about investment, when you talk about those 5,000 additional front-facing Wealth relationship managers, and when you think about that 10% Wealth revenue growth? Where is it coming from? Is it about net new money growth because you've grown very nicely up to now? Is it about cross-selling of lending? Is it about shifting liquidity on to Asset Management products? Can you just give us a sense of what's going on there and the connectivity between those Wealth/Private Bank/Asset Management side? So that's my first one.

My second one is about fees versus NII, because we've talked about it previously from a perspective of defending the revenue line in a low-interest-rate environment. And of course, Wealth is one part of the discussion to it. Of course, we've also talked about global transactional banking and repricing of some products there. Give us a sense of what's going on.

EWEN STEVENSON: Sure. There was a lot in that, so I'll start off and maybe I'll get Ming and others to join in on Asia. Wealth, definitionally for us is what we call Premier and what we call Jade, and Private Banking. It's insurance, it's asset management, so it's a pretty broad definition of Wealth.

Firstly, we put up the other day – if you just look at the underlying macro growth rates in Asia, we expect them to be high-single-digit growth rates. So in terms of our own growth aspirations, we are expecting to grow marginally ahead of market, but it's not like a dramatic multiple of market growth that we're seeking to achieve. I'll get Ming to talk about things like Pinnacle and other things that we're doing in Asia. As we look at the competitive landscape out there in a number of sectors, we think we are competitively advantaged versus peers.

Firstly, if you think about we're the only bank that we think in the region delivers a strong private bank, a strong commercial bank and a strong investment bank. You all know I've worked at Credit Suisse in my past. They had a strong private bank and a strong investment bank. They didn't have a strong commercial bank. So what we offer is the ability to effectively bank first-generation family money in a very, very different way, we think, to any of our peers. If you look at the bulk of the referrals coming into the Private Bank, they're coming from the Commercial Bank and the Investment Bank currently. So just working our network better, we think, delivers an enormous amount of organic growth for us, before we go out and find new customers outside of existing customers of the bank.

Secondly, again, I think we put the Chinese diaspora market share somewhere in the presentation, but we do a very, very good job globally at banking the Chinese diaspora, but equally, we think we've done a very poor job at banking the Indian diaspora. There's no reason we shouldn't have a far higher market share, given the skillset we have to bank immigrant communities around the world, so again, you will see a big chunk in the India presentation on doing a better job with non-resident Indians, and it's really about leveraging the skillset that we've built on servicing non-resident Chinese.

There is a deep connectivity between the asset manager, the insurance company, the private bank. If you look at flows into the asset manager, a meaningful portion of them are from the Group rather than external to the Group, so the whole model is self-reinforcing, in a way.

Ming, do you want to pick up on Pinnacle and a few of the other things?

MING LAU, CHIEF FINANCIAL OFFICER, THE HONGKONG AND SHANGHAI BANKING CORPORATION: Yes. Thanks, Ewen. So I guess on Asia Wealth, a big component of it is China. I think Peter spoke to this during the earnings release, but the expectation is, if you look at China, we're expecting the middle class to grow from roughly 300 million today to 600 million by 2028. We believe that growth drives a significant opportunity in the Wealth space. A big part of our investment here in Asia is called Pinnacle. So the plan there is to, essentially, hire 3,000 Personal Wealth planners. So these will be mobile Personal Wealth Planning RMs that go around selling insurance and asset management products to our clients.

Beyond that, I think the way to think about Asia Wealth, and given our strength and our market share in Hong Kong, the opportunity is really arising also because of Wealth Connect, and that's a big part of the GBA strategy for GBA integration on mainland China. But Wealth Connect, we are expecting much more opportunity in terms of flows of investments from mainland China into Hong Kong, and vice versa.

Beyond that, the other areas I would say would be Private Banking. So we have a pretty small Private Banking presence now onshore in China, but given our securities JV in Qianhai, we believe we can use some of the licences we have in that entity to start now building out Private Banking onshore.

I think, beyond that, linking to Private Banking, it's Singapore. We've invested over the past couple of years in Singapore in terms of building out the Private Banking business. We've had some pretty good results. I think net new money for Asia in Private Banking has been in the range of $14-15 billion in the past couple of years, and the plan on Private Banking is, over the next five years, to add about 600-700 headcount in that business. But yes, I think, naturally, Asia is going to have a bigger and bigger portion of the middle class relative to the West, so I think that, given our strength on Wealth in Asia, that aligns well with our ambitions.

EWEN STEVENSON: And then on the question, on fees, if you think about 2020, there were a few things that went on. I think it's in note 2 or something like that in our results, and you should look at it. What you see is anything connected with customer activity around Wealth, trading, broking fees etc had a very good year. The core banking fees or anything to do with remittances, etc got slammed, so we do think, on those line items that got slammed because of Covid, there will be a natural sharp recovery coming sometime this year, potentially partially offset by coming off some highs on things like broking fees. And then you get the core build-up of everything we just talked about, and then trading income should come down from the levels we enjoyed last year, but it would still be above 2019 levels. The only thing that I think we are going to have to come back and talk to you about later this year is the impact of IFRS 17 on all of this as well.

YAFEI TIAN, CITIGROUP: Good morning. I have two questions. The first one is that I wanted to have a better understanding what is the capital market business trends year to date compared to the same period last year. It looks like the market volatility is still quite high at the moment. Similarly, here in Asia, the Hong Kong exchange trading volume almost doubled year on year. How is this going to impact your Wealth business outlook for this year?

And the second question, just to pick up your earlier comment on Hang Seng Bank holding a lot of high CET1 ratio; if you look at Hong Kong banks, it's not too dissimilar to what other Hong Kong banks are holding at the moment, and maybe also HSBC Asia also holds very high CET1 ratio. Are you in discussion with the regulators in the region? Would there be much pushback if you wanted to upstream that capital to the Group and even consider deploying to other parts of the region? Because my understanding is that there is a lot of protection. Each market tends to operate to hold capital within that district. Thank you.

EWEN STEVENSON: There are always complex discussions with regulators everywhere we do business. If we go back to first principles, the bank should hold sufficient capital to withstand various stress events with a recovery plan that gets them back to acceptable capital ratios within a reasonable time period, so that is the methodology and thinking that we do both with the Group and the subsidiaries everywhere. And yes, I would observe in Asia that, historically, Asian banks have typically held capital in excess of that methodology, so that's an ongoing discussion that we have with regulators in the region. That thinking, I think, is far more mature in the US and the UK, for example, but yes, at some point, if you say, why did we target that 14-14.5% range, it's because we've got confidence over the medium-to-longer term that we can probably repatriate an element of capital above that, out of Asia and back to the UK. But as you know, that's a complex discussion with various regulators that will take some time.

On Global Markets, I think equities has been very strong this year, but, as you know, we don't have a huge equities business. I would say some of the fixed-income lines have been okay, nothing different to what we broadly would have expected at this point. But overall trading volumes have been okay and we're probably ahead of where we thought we were going to be for the first two months or so, but nothing like the degrees of outperformance we might have seen for the full year in 2020. But Hong Kong retail players have been very strong, so I think they continue to see very healthy flows on retail activity in Hong Kong. Offsetting that, from a Hong Kong P&L perspective, is a HIBOR rate that's much lower than we would have anticipated a few months ago.

RICHARD O'CONNOR: I'll just add, Yafei, we're slightly different to other investment banks in terms of having a strong January, but clearly, Chinese New Year slows February down versus, for example, US investment banks. So there's a different seasonal pattern to us compared to particularly the US and European investment banks.

EWEN STEVENSON: Ming, I don't know whether you'd add to the capital discussion or trading discussion in Asia.

MING LAU: Yes. It's had a really strong start, because you know that volumes are almost double, or more than double what they were at the same period last year. The southbound flows from China have been pretty strong. I think the other thing I would point to is the fact that there's probably in excess of 150 IPOs in the pipeline right now for Hong Kong. So I think, given that, it's probably given a positive outlook for Hong Kong in terms of potentially sustaining those volumes, but again, it is early days right now for the year.

YAFEI TIAN: Thank you for the colour.

GUY STEBBINGS, EXANE: Hi everyone, I've got two questions. The first one, hopefully, is a relatively easy one. So it's just on Corporate Centre RWAs, which keep on rising. I think they're up about 25% over the past couple of years to over $90 billion. I appreciate there's probably some FX in there, but what's driving that increase? It looks like quite a lot came from Asia, so not necessarily the regions where restructuring is most prominent.

And then the second question was just how to think about investment spend in the more medium term. If I look at that 7-10% CAGR for 2019-2022, beyond that, if that persists and simple maths suggests it becomes a very large and growing part of the cost base, and perhaps

BAU cost reductions become incrementally harder to achieve as we look further ahead, putting some pressure on the cost base, so I guess my question is: is there something very specific about the next couple of years such that that investment spend should drop down, or is that investment spend really what's needed to deliver a competitive and evolving proposition to customers, and actually spending more and more part of the BAU cost base for a successful bank?

EWEN STEVENSON: Richard, do you want to pick up the RWA point?

RICHARD O'CONNOR: Yes, and I'll get Ming to chip in. It's mainly to do with the investment in BoCom, which increases in value based on the value-in-use calculation and the fact that accrued RWAs have been stable to down, given our RWA programme. So that would be the main issue, but Ming, I'm not sure if you can add any further colour to that.

MING LAU: Yes. Thanks, Richard. I guess BoCom is probably the bulk of it, but also we've seen an increase in asset mix going into cash and HQLAs, which are largely deployed by Markets Treasury. That's just driven by overhang of deposit growth relative to loan growth.

EWEN STEVENSON: So we increased the capital allocation to Markets Treasury deliberately to, basically, try and enhance the yield that we were getting on surplus liquidity. That's part of the answer. But that will either be more permanent or not, depending on where deposit balances and lending opportunity comes from in the coming years.

The second question on investment: if you think about what we're trying to achieve when we talk about stable costs over the medium-to-longer term, that's a mix of gross and net. What you should expect is that technology cost becomes an increasing component of the bank's cost structure, and anything to do with people and physical infrastructure etc should become a declining percentage of the Group's cost structure over time. The more that we can invest in technology that drives fundamental productivity improvement, the more that we free up investment spend to be able to continue to drive increased productivity improvement.

We talked a little bit about the Finance function, which obviously I'm very close to, but we are in the middle of a big project with Google to shift all of our reporting onto the cloud. We started with liquidity reporting that we've got up and running now in about 50 countries globally. We've now started on risk-weighted-asset reporting in the UK in the last few months. We're processing 18 times more data eight times faster, so it's a 150-times uplift in terms of the processing capacity, and the level of insight, therefore, that we're getting on RWAs in the UK, given we're processing 18 times more data, is a level that we've never had before.

So I think we're only beginning to understand the real power that technology-transformation project is going to have on Finance. What we do know is it will enable me to drive down the costs in Finance by about a third in the coming years and to take out about a third of the headcount, which means, from late 2018, when I joined, through, say, 2023/2024, we'll have halved the headcount and halved the cost of Finance, and still be delivering a much better customer outcome in terms of quality and granularity of MI, and a much better control outcome, because far more of our controls will be automated.

It's that sort of stuff that we want to invest in. So in the back office, John Hinshaw, who was talking the other day, has basically changed out much of his management team, and we just think there's enormous opportunity to basically invest in technology and replace an enormous amount of manual processing work and manual reconciliation work that goes in across operations in various functions: Finance, Risk, Compliance etc. But that's a four-to-five-year journey for most of us in terms of that technology transformation.

Another big piece is Zoom and what's happened with Covid has allowed us to fundamentally rethink how we go back to work. Again, we talked about using 40% less commercial real estate investment in head offices. That's not driven by a 40% reduction in headcount; it's just we're going to go back to a much more hybrid working model, where people are not going to have to come into the office five days a week and, therefore, we can get a much more efficient usage of our commercial real estate, coupled with a need to travel a lot less.

And then, in the front office, it's the investment into digitisation, so just the very rapid uplift that we're seeing in digital engagement on mobile, which has been further accelerated because of

Covid. And on the other side of that, just a rapid decline in branch visits, traditional contact-centre calls, use of cash, use of ATM machines and the like. And then on the more high-end parts of the business, a massive uplift that's coming from the investment in technology in terms of Relationship Manager productivity.

So when you put all that together, there's this very highly virtuous cycle of the more that you can spend on investment, the more that you can drive transformational uplift in productivity, the more that you can spend on investment. So whether that gets you to a compound 10% growth in the future beyond 2022, I don't know, but from my perspective, the more that I can invest in productivity change driven by technology, the better. Richard, I don't know whether you've got anything to add.

RICHARD O'CONNOR: No, that's very comprehensive, thanks.

RAUL SINHA, JP MORGAN: A few follow-ups from the discussion, very interesting in terms of what you're saying on what you're able to achieve in terms of cost savings. Can I ask how much it cost to move the Finance function – just broad numbers or relative numbers – onto the cloud and what sort of savings you realised? And if you were to compare that to how much it costs to exit real-estate footprints and the savings that yields. I think that from the outside I don't know for sure but, clearly, digitalisation might have a better payoff than exiting real estate, but I was wondering if you could share some –

EWEN STEVENSON: Yes. If you had the choice, you're right that the finance on the cloud investment is probably a PE of 1 or 2 – probably a PE of 1, I think, in terms of the investment. Well, call it 2. The investment in technology plus the redundancy costs of getting rid of people probably has a two-year payback. The real estate is an inevitable outcome of having less people, but again, it all depends on break clauses.

So if you think about our London footprint, for example, Canary Wharf is a lease contract that runs to 2027. We have a whole bunch of property elsewhere in London that has earlier termination rights, so if we're smart about managing the London property footprint, we can manage this as headcount reduces. We'll just have a lease out for renewal. We won't renew it. Those people will shift to working out of Canary Wharf. If you've got a very good, multi-year, developed plan, you can do a lot this much more efficiently through just either natural attrition of headcount rather than redundancies, or just natural termination rights. But typically, the payback on exiting real estate only makes sense if you're also getting out the people associated with the buildings which you're exiting.

RAUL SINHA: Do you have a sense of how much real estate cost you would be able to save over the medium term relative to where you are today?

RICHARD O'CONNOR: Our real estate costs outside the branch network are about $3 billion. It's not going to be a 40% saving, because we're going to be upgrading the quality of our estate, increasing in technology automation even within that footprint, and you know what the trend in branches is and we made some announcements earlier on that. So those are the type of numbers which you're looking at, but the fundamental one is fewer people over time but upgraded skills of those individuals to cater for the new environment.

RAUL SINHA: And the natural rate of inflation for you across the Group – cost inflation?

RICHARD O'CONNOR: About 3%.

RAUL SINHA: I have one more question, just very quickly. I was trying to square the comments you were making on the call that you had planned an assumed rate hike with that HIBOR assumption slide, which shows it's moving up to 90 basis points. And I suspect that you are assuming the gap between LIBOR and HIBOR starts to widen. Is that a house view? Are you expecting the liquidity to normalise and that's what causes it? I was just wondering if you've got any more colour on that.

EWEN STEVENSON: I think what you see in terms of the way our forecast is done – and these were constructed, I guess, a few months earlier – for our plan, we just use consensus rate forecasts when we put them together.

RAUL SINHA: Got it. So when you did it, that was the consensus. Got it. It's moved on since then.

RICHARD O'CONNOR: HIBOR is very, very difficult to forecast and your view is as good as ours, but our view – and Ming can chip in – is that we do expect an increase in loan demand in our business in Hong Kong and Asia as you go throughout the year, as companies reopen and companies need to invest to upgrade their businesses. A huge amount of investment in terms of green technology and other types of investments, and we fully expect to be supporting our clients in that growth and investment as we come out of Covid. And that could have an impact on HIBOR as well.

FAHED KUNWAR, REDBURN: Thanks for taking my question. It's just a follow-up on the detail you gave on the technology spend. One of the things I noted was I think your BAU versus investment spend is 50/50. If I look at, I think, Temenos, in their Capital Markets Day, the Global Banking group having more like 25% in investment and more like 75% in BAU. Over and above the very good detail you just gave to Guy's question, what is it you've done that leads to the capability of your IT spend being far more investment-heavy than just patching up systems, which I guess is what BAU is?

And my second is just so I understand: are the clear benefits there going to be, essentially, wider jaws than we would expect? And a second, potentially: is there an operational-risk-weight benefit as well? So that's my first question with a couple of parts, sorry.

My second one is just a follow-up on HIBOR and just on the comments you were making. This is a bit of an unfair question, but are all the capital inflows coming into Hong Kong one of the reasons that HIBOR is just struggling or not reacting to the US LIBOR rate going up? What do you think about the outlook for HIBOR? I appreciate it's a very volatile number, but you're closer to it than we are. How do you think about that HIBOR number?

EWEN STEVENSON; Ming, do you want to talk about HIBOR?

MING LAU: Yes. I think, if you look over the last few months, the amount of capital coming into Hong Kong is driving that. So if you look at the exchange rate, it's still holding at the stronger end for the Hong Kong versus US dollar. And if you look at the aggregate balance for Hong Kong, it continues to grow. So I think, as long as those trends continue, you're going to see a depressed HIBOR rate at this point. And I think, previously, I commented on this too, but there's a significant amount of IPOs in the pipeline, so as a result, I think you're going to continue to see good amounts of capital coming into Hong Kong.

FAHED KUNWAR: Do the Connects between China and Hong Kong structurally mean that the link between LIBOR and HIBOR is going to change? Can we go as far as that or do you think it is more transitory than that?

MING LAU: Too early to be able to comment on that at this point.

RICHARD O'CONNOR: Fahed, I'll give a view. You're going to see very strong liquidity in Hong Kong and strong IPO activity and southbound activity, and I will repeat – and this is a global comment – our clients have a huge amount of liquidity, which, at some stage, they will put to work, and so that's when you may see a change. On HIBOR/LIBOR, you can do a 20-year chart and it's very volatile, but they tend to track other, on an average view, over a medium-to-long-term time period.

EWEN STEVENSON: Maybe I'll pick up the operational-risk RWA point. You're right: over time, it should lead to lower operational-risk RWAs because you just reduce manual control issues that exist today, so you should have a much better controlled operating environment. I would say regulators, undoubtedly, will find other ways to ensure that operational-risk RWAs don't fall dramatically; for example, climate risk or whatever new risks are they see emerging. So to be explicit, we haven't built anything in to our RWA forecasting that assumes a dramatic improvement in our operational-risk RWA benefits. Richard, on the technology split?

RICHARD O'CONNOR: Yes, let me cover that. I think, Fahed, you should look at the technology slide which John Hinshaw – the middle one – which shows the investment related purely to technology. We're not so out of line with peers as you would expect. We spend a lot

of money on run-the-bank, compliance and mandatory programmes, but that chart is meant to show that we are increasing the proportion investment over time in what we would call growth capex. So that's the view but we're not so out of line with peers as what you think, and we can take this offline. So the difference between the investment in the technology budget and the overall Group investment, and have a look at John Hinshaw's middle slide in the deck, and that will show you more details.

The one thing I'd add to everybody is: please don't formulaically put buybacks in the model automatically. Firstly, the Group is in growth mode and it's time to reinvest into Asia, as we set out earlier in the week. And secondly, as Ewen said, it will take two, three, four years to get the capital in the right place. So whilst we have been active in buybacks in the past, and no doubt will be in the future, please don't do it formulaically. Have a chat with Mark and Tim or myself to discuss that further, please.

EWEN STEVENSON: Thanks, everyone, for participating today. I guess, just overall, I think if there is a difference of view between us and you, it's as you would expect; we're much more bullish on the medium-term upside in the Group. As I said the other day, if we just get to credit normalisation and take the savings of the bank levy, the 3% ROTE goes to 6%. And when I look at the current forecast for 2023, we're not getting a lot of credit for any management improvement beyond that. We do think, and are reasonably confident, that there is material ROTE upside from there, together with what I described as the free option on a better near-term rates environment than we've got currently. But thanks, all, for joining today.

RICHARD O'CONNOR: Thanks, everyone.