HSBC

Transcript

Post-Results Equity Analyst Call
2022 Results

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RICHARD O'CONNOR, GLOBAL HEAD OF INVESTOR RELATIONS: Good morning, good afternoon everyone. This is the normal HSBC follow-on analyst meeting. I'm delighted to see our friends in Hong Kong; we'll make sure that our Hong Kong analysts get to ask some questions. We don't have a pre-prepared script. It's very much your meeting to ask questions and anything we didn't answer well on Tuesday.

We should start with a thank you - this will be a difficult first half for all of us - we've got IFRS 17 and the change to legal entities, so I understand this will be a model rebuild. I think at the end of it we will get a better construct in terms of how the business is managed by the legal entity, and how we manage non-interest income and the drivers of that. NII has been a big subject and will remain so, but non-NII, I think we need to do a better job of helping you model those drivers, and where we're doing well, where we're doing less well. That's work in progress, so I appreciate your help with that over the next few months. With that I'll hand over to Georges.

GEORGES ELHEDERY, GROUP CHIEF FINANCIAL OFFICER: Thank you very much, everyone, for joining. I want to say a welcome after two months in the job. In 18 years at HSBC I've ran a number of businesses, so I'm quite familiar with this place, but obviously new to this function. I'm also joined this morning by a number of people, obviously by the IR function with Richard and his team. Carlo's joining me, group treasurer. Kathleen should be on the phone, who's Head of Finance. Very shortly we'll be joined by our Global Financial Controller, Jon Bingham.

RICHARD O'CONNOR: You've got Mark Phin and the IR team in Hong Kong who will help direct the questions from Hong Kong.

GEORGES ELHEDERY: And we have Ming, our CFO for Asia.

RICHARD O'CONNOR: Who can tell us what HIBOR's doing. Perfect, so with that we'll go straight into questions.

TOM RAYNER, NUMIS: Could I have two, please? Richard, you started with disclosure, so on disclosure I'm wondering what your thought process was about doing away with adjusted disclosure. I think in some ways that might make things more difficult to interpret – issues with consensus and what's in and what's not, etc. I'm just interested in that and whether you've had any thoughts on other potential changes like moving to a banking NIM rather than having trading revenue and expenses messing things up, and whether or not the use of pro-forma figures might be quite useful when you've got big accounting changes coming or big disposals like Canada - just giving us pro forma today - that would be very helpful. That's just some thoughts on disclosure.

RICHARD O'CONNOR: Let's deal with that first, Tom. Georges, if you do high level and I'll deal with the specifics on that?

GEORGES ELHEDERY: First, we're not fully removing adjusted, because at this stage we decided to retain the constant currency adjustment. Currencies have been quite volatile, and we thought let's take it sequentially and not create more uncertainty due to the constant currency adjustment. This one we are retaining.

First, we're moving away from the CTA programme. Second, we wanted really to convey the strong sense that we're managing every line item in our income statement and our costs. We didn't want any impression that things may just slip below the line and we're not necessarily as focused and as purposeful as managing them as the ones we're managing above the line. That's the main intent.

We will still call out notable items if there are notable items, we just raised the threshold to $250 million from the current $150 million significant item threshold, but obviously if there are notable items we will call them out and we will make sure you can see the underlying business performance from these notable items, but we're not going to have two sets of numbers going forward apart from the FX adjusted.

On your second point about banking NIM, it's actually our intention to transition to banking NIM, and it's our intention to do so progressively by allowing all of you to understand how we're computing it and have a parameter for some period of time. Essentially, the main difference between the banking NIM and the current accounting NIM is the funding of the trading book. In our accounts you'll still have an accounting NII, and the rest of it will fall in the non-NII, but at least you'll be able to quantify it because we'll be giving a banking NIM.

Equally, a banking NIM will effectively neutralise the effect of the funding of the trading book, because the income would be generated - it will just sit on a different line - NII or non-NII - depending on whether it's the trading book paying for the funding of it, or if it's the banking book or treasury book paying for the funding of it. We neutralise, if you want, some of that uncertainty.

On your third point about pro forma, we did put in the appendix of the presentation a pro forma for Canada. The main things to call out - the first is it's about $60 billion of deposits and $60 billion of assets which will drop off the balance sheet. It will add about four to five additional basis points to the ECL coverage ratio on the residual book.

The other element that you need to be mindful of Canada is that the earnings of Canada for this year will be due to the lockbox structure we did on the sale of Canada. The earnings of Canada will be recognised as earnings and will be deducted from the purchase price, so therefore for all intents and purposes the earnings after tax are not ours. By the sheer fact of being deducted from the sale price, effectively the buyer already owns the earnings, and that started from 30 June 2022.

The last thing I want to share about Canada is that there will be an additional 130 or 140 basis points on the CET1 ratio. That is coming from the gain on sale of pro forma $5 billion, roughly $5.7 billion minus the earnings of Canada that will accrue over the year, and from the release of the RWAs of Canada. Of that CET1 ratio, we intend to pay the special dividend, conditional to successful completion of the transaction and the right approvals, including board and regulatory. We'll pay the 21 cents as the first priority, and then the additional capital surplus will support any share buyback programme we have running at that stage and will support any business requirements or regulatory requirements we have at that stage.

RICHARD O'CONNOR: The only thing I'll add before your second question, Tom, is clearly you saw the disclosures. You may have missed it. The insurance net interest income will go to non-net-interest income. There'll be a residual about $400 million of net interest income in the insurance line, but we'll split that out for you when we do the NII walk, but we are moving to a banking NIM as quickly as we can, Q1, Q2, because I think it's better for you and you get a better understand of that. Bear with us and we'll get there.

TOM RAYNER: Thanks for that. The second question was on costs, and you mentioned you're moving away from the whole concept of CTA, etc. Restructuring costs in 2022 all in were about $2.9 billion, and all we know about, which might be comparable, is the $300 million this year for severance. The $1 billion of flowthrough cost saves is helping you keep that cost growth number down to 3%; it seems to me very hard that you're going to be able to generate the same sort of flowthrough cost savings into 2024 unless you are going to make significant other investments in cost initiatives, etc. I'm just wondering if you could comment on that, because the guidance is clear for cost growth in 2023, but it looks like into 2024 there's some upward pressure on that number.

GEORGES ELHEDERY: Thanks for that question. The transformation we've gone through the CTA programme over the last three years we don't expect to continue with the same pace. I want to give you some numbers. Through that transformation we reduced our operations cost in the bank by approximately 20% and increased our technology spend by approximately 20%. That takes our technology cost from 16% of our total cost in 2019, taking it up to 20% by 2022. That sheer size of transformation we don't expect to repeat, so we're comfortable with the technology cost at 20% of total costs. This is why, when we're saying benefits flowing through, it's really following massive adjustments which we're not looking to replicate with that same magnitude.

The $300 million severance will allow us to continue to do that, so again, we're using severance, mostly for management and senior management layers. If we wanted to adjust costs in our general population, this is much more easily done through natural attrition. We have anywhere between 6% to 10% natural attrition, depending on years, and that's the right mechanism to use to adjust costs. We earmarked that amount mostly for senior management layers and roles that we want to still tackle, but you probably won't expect the same size shifts that we've seen before.

Therefore, if I want to sum it, while we have not given guidance for 2024 – and we think it's a bit premature, we just need to see also how inflation is going to pan out this year – we're absolutely committed to the cost discipline that we have committed to for 2023.

OMAR KEENAN, CREDIT SUISSE: Could you help us or talk through with us the changes in the interest rate sensitivity over the last six months of the year? I know there was an NII stabilisation programme, which should make the NII more resilient going into future years, but if you could help us with what structural hedges look like now in terms of duration, and just explain the rate sensitivity so we can make sure we're sequentially modelling things right?

GEORGES ELHEDERY: The NII sensitivity dropped for our 100 basis points downside for rates, annualised from about $6 billion to $4 billion. I just want to remind you first the assumptions under the sensitivity. The first one is a static balance sheet, so we just assumed the balance sheet, as is, no migrations, no additional or reduction of deposits, etc. The second assumption is a flat 50% passthrough rate, which we know is not necessarily real life, but it gives you a guide.

Of that $2 billion reduction, circa two-thirds is coming from the fact that we're at higher rates than we were in Q2, and therefore you do have less of the negative convexity when you're compressed around zero. Further out from zero, the less sensitivity you have. That's about two-thirds of the reduction, and one-third of the reduction is the additional structural hedges which Carlo and the treasury team have been putting in place. We've always had structured hedges, but obviously when rates are close to zero for a period of time you're not necessarily inclined to extend your maturities at those rates, so you just wait it out. Where rates are today allow us to extend it and allow us to expand the volume. This is the journey we're on, and it'll take us easily through mid-2023, probably longer, to be in a position where we're partly mitigated.

I just want to clarify: we will always have rate sensitivity and short-term rate sensitivity. We're not intending and we cannot hedge all of it, and there are reasons for that. Some reasons are we need to maintain some of our exposure to short-term rates. That's a risk management reason. Other reasons are that you don't always have the instruments to hedge, and this is particularly true in Hong Kong, where you don't have enough long-term HIBOR or Hong Kong dollar related instruments to hedge with, so you're de facto constrained by the market capacity. Number three, we also want to make sure that any of these hedges is done in an as capital efficient way as possible. There's no point creating a hedge but creating capital volatility, so NII stability versus capital volatility. We need to manage that trade-off in a way that keeps us comfortable. You'll always see exposure, we're just trying to reduce it.

RICHARD O'CONNOR: Carlo, anything to add to that?

CARLO PELLERANI, GROUP TREASURER: The only things I would add is, first, your question about maturity. Broadly speaking, those are on average five-year transactions, so they are five years to start and they will roll down. Just to stress what Georges was saying - this is not a trading position - the objective here is stabilisation, so the idea is to smooth the income to the downside and avoid giving it up on the upside. Obviously this is an art. It's impossible to pick the right time in the cycle. We have started at this point in the cycle, adding, as Georges is saying, we are in part on the way there. We will continue to review.

PERLIE MONG, KBW: Just a couple questions on Hong Kong. If I look at your fee income in Hong Kong minus the manufacturing market impact it looks like we're about 10% below 2019. Is that fair? From the sounds of it on the call earlier in the week it sounds quite constructive, it's picking up again, etc. Can we expect a catch up this year or are we structurally different, or is there any reason why we're structurally different?

RICHARD O'CONNOR: Let's get Ming to take that, Ming in Hong Kong. Fee income down 10% since 2019. What are the prospects going forward?

MING LAU, CHIEF FINANCIAL OFFICER, ASIA-PACIFIC: I would say for the drop in fee income in Hong Kong, a big part of it was the reductions in Asia Wealth fee income, particularly on the Asia wealth distribution side of the business, which naturally, if you look at it, has been impacted by two particular dynamics. One would be the drop in equity prices, both in Hong Kong and markets globally through 2022. Secondly, in Hong Kong the Hong Kong stock exchange turnover fell, which naturally would have impacted your brokerage revenues. In terms of seeing a recovery of the fee income for Hong Kong particularly, I would point to those two factors.

I think we've seen a good start so far in 2023. There's been just broadly over a 10% pickup in Hong Kong stock exchange turnover thus far through the early part of the first quarter. So look, it's positive at this point, so a bit cautiously optimistic, but I would say you would have to continue to see recovery of the equity markets and continuing pickup of the stock exchange turnover to see a pickup in Asia Wealth revenues.

I think, beyond that, trade financing activity clearly was impacted in the second half of 2022, so one would have to see a recovery in the trade financing activities to see a pickup in the transaction finance fees overall.

PERLIE MONG: That's very helpful, thank you. The Hong Kong budget was out yesterday and the key thing there – and has been for a while – is the Greater Bay Area and the integration of Hong Kong into the Greater Bay Area. And certainly, your colleagues in Hong Kong have repeatedly highlighted the excitement around this opportunity. Can you just give a sense of the potential you're seeing there? What sort of market share gain are you targeting in the next few years, etc?

MING LAU: Thanks. Yes, look, again, I would say cautiously optimistic. I think that GBA opportunity is potentially significant for us, but, as we've noted in the past, it's early days. I think you do need to continue to see some of the policies continue to evolve to see freer flows of capital, etc, and investments between Hong Kong and the GBA. So I think the bigger impact for us at this point through the first half of this year would be the borders reopening and the impact that that has in terms of the number of visitors coming back into Hong Kong. And I think, through the first part of the year, and particularly January, we've seen the number of visitors just numbering below half a million, which is a good pickup from the Covid days, but still only about 10% of the levels we used to see in terms of levels of visitors coming into Hong Kong.

RICHARD O'CONNOR: And we'll talk more, Perlie, about the GBA opportunity in the seminar in May.

RAUL SINHA, JP MORGAN: The first one is just to follow up on what was said on the call around NII and the fact that consensus shouldn't move. You weren't looking to move consensus. Can I just clarify that that comment was pre-IFRS 17 impact? Because it looks to me like, based on slide 40, that there's going to be a negative impact from IFRS 17 on NII.

GEORGES ELHEDERY: That's absolutely correct, Raul. So this is guidance on an IFRS 4 basis. We will give you a restatement of this guidance under IFRS 17 with the Q1 results. We're first waiting on 9 March for the key changes from IFRS 17, so you have all the dynamics. Broadly speaking and just paraphrasing what Richard mentioned earlier, about $2.2 billion of the current IFRS 4 NII will flip like-for-like into non-NII, due to IFRS 17, and then there will be a number of additions and variations on the earnings statement that, net/net, will take out about two-thirds of the insurance PBT of broadly speaking, $1 billion. About two-thirds of it will disappear from the year's earnings and then will start accruing over the following years, and that's through additional changes in the cost line and the non-NII element. But pure NII, at this stage, is c.$2.2 billion, which will drop from that.

RAUL SINHA: Thank you. That's really helpful. And then, second question, just a little bit more broader, Georges, in terms of what you're trying to do in terms of reducing the downside sensitivity to rates as the rate cycle probably peaks out, but you're saying you can't completely hedge the downside risk. When you think about the medium term, there's a risk that rates would fall from here and that would put pressure on the profitability of the bank, because of the NII disappearing. How do you think you can manage or mitigate that in terms of some of the levers? It doesn't seem to me like cost could be an absolute lever from here, so do you think that growth in the other areas of the bank will pick up sufficiently to offset that?

GEORGES ELHEDERY: Look, it's a legitimate question. If you look at a lot of the investments we're doing – in the non-NII and specifically in the fee income line, if you want, and the investments we're putting in Wealth. And if you assume both our own investments plus the market outlook improving from where we are, there is, cautiously speaking, potential for substantial growth in this space. If you look at the growth in our fee income, say, in trade finance, despite all the challenges we faced and global supply chains, we continued to see a resilient mid-single-digit CAGR in this space. So there is a clear focus on our net fee income growth with a lot of investments in this space. So that is one area.

And the other area is we are now considering bringing forward our share buyback programme, and the capital generation we will have over the next couple of years, based on the current outlook, will allow us to have substantial share buyback capabilities, which should allow us to manage, if you want, the available share pool for distribution of dividends. So there'll be a number of factors which will help us mitigate.

This being said, if rates go to zero, it's a challenge, but we think rates at zero is an aberration and we don't think any normalisation – if we think, today, rates have peaked - we don't genuinely think a normalisation will take us back to zero. That will be an aberration, if you want, there.

RICHARD O'CONNOR: Carlo, anything to add to that?

CARLO PELLERANI: Yes, I would just say that, of course, there are already actions that the Group has taken thus far. We think that the Group, at similar rates to the past, is returning about 3% ROE higher than it was at similar rates, thanks to the actions taken thus far. Stabilisation will help temporarily. Again, stabilisation is not trying to trade, so it will fizzle out over time. But hopefully, if there is a temporary downturn, it could help sustain, and then the additional actions that Georges has mentioned.

JOE DICKERSON, JEFFERIES: Just two things from me. So this 130-140 basis points benefit from Canada, you've said the first priority is the 21 cent special dividend. I've got a couple other questions. It sounds like you've given – buybacks and then investment in the business is the other two items, but what I'm getting, if I'm reading between the lines here, we should not assume that it's fully distributed via buybacks and dividends. Is that fair? And on that, is the acceleration of the buyback in H1 simply related to the fact that you had very strong capital generation in Q4? Presumably you'll have it again in Q1. Are you, effectively, pre-funding any of this, or is that separate to what you might get from Canada?

And then, on the Group structure, Noel has explained the fungibility of Mexico with the rest of the business. What about the fungibility of the Australia operations with the rest of the business? Is that ever a business you'd take a look at strategically, or is it fungible enough to retain?

GEORGES ELHEDERY: Firstly the 130-140 basis points; the 21 cent special dividend is the first priority use. We haven't given additional indication on the other uses, because we're probably still a year early now. We will give you more clarity as we come close to closure, but closure is still expected towards the end of this year.

JOE DICKERSON: Can I just ask, on the closure point, there's only, I don't know, 10 banks in Canada. Why does it take so long?

GEORGE ELHEDERY: Well, the technology transition process - the legal process requires a few regulatory approvals, including the competition authority's approval, and that's a clear process - but the actual technology transfer is the challenge.

JOE DICKERSON: I understand.

GEORGE ELHEDERY: So we will give more indication, but maybe I'll answer your second point, which clarifies it. We are in a buyback programme. First, we're not pre-funding. The consideration to bring forward the buyback programme is based on our capital generation and our capital position today. We are not pre-empting an outcome of Canada to do that. So therefore, any outcome from Canada is just an additional buyback capacity.

Now, the reality is there is only so much capacity you can hit the market with for buybacks, so the likelihood of Canada, if we are in a buyback at that stage, is not that we will increase the volume, because we will probably be at the right capacity. It will, effectively, extend in time. And if it's extending in time – capital is fungible, right – then we can co-mingle our own capital generation as well as the Canada proceeds and the contribution to that.

The guiding principle for a buyback is excess capital. We indicated our target operating range to be 14-14.5%, at least for the short-to-medium term. We're looking, beyond the medium term, to bring it lower. Any excess capital beyond what we're comfortable with within this range is for distribution. So if we can't do it in the same timeframe because of the volume, it will extend the programme longer in time.

JOE DICKERSON: I asked the question because they're quite large sums that you get to if you have strength of capital generation in the first half of the year and you're exiting pretty large numbers for Canada. That's why I asked the question.

GEORGES ELHEDERY: That is correct. This is why we need to be quite mindful of how much we come to the market with at every quarter.

RICHARD O'CONNOR: So you should assume that buybacks extend into 2024 and 2025, for that reason. And you'll notice that we did the first ever Hong Kong buyback last year, and that wasn't easy to execute, but we did it and it's now on track, so that helps the volumes. But you should assume an ongoing buyback, subject to us performing as we currently are and hitting our targets over the next couple of years.

JOE DICKERSON: What's the maximum that you can do?

RICHARD O'CONNOR: We wouldn't give that number, but if you think about 10% of volume across all exchanges, that will give you a good indicator. It's a nice problem to have. We would probably max out at 10%.

On Australia, it's a good question, and we can talk about Mexico a bit, and we have done before. Australia is – you can't shrink your way to glory. People think you can. You can't. You've all been in the banking sector decades, many of you. Shrinking to glory never works. We are the international bank in Australia, and we are the international bank in Australia into Asia. It's very well connected. It's a very strong franchise. Canada is a very strong franchise, but, because of the acquisition, it was more domestic than you might think. And we can support Canadian companies going to the US, but there's dozens of banks that can do that, so our DNA is into and out of Asia and the Middle East and, therefore, we have a primacy in Australia which provides that connectivity into Asia and the Middle East. So therefore, you can cut arms and legs off, but that's not something I don't think we would support.

MATTHEW CLARK, MEDIOBANCA: Can I ask a question about the balance sheet growth guidance – the low-single-digit then reverting to mid-single-digit the following year? So what are the overs and unders there by sub-segment? Are there any areas where you expect to see material shrinkage this year or material growth this year, despite the broader environment? And then in terms of the more normalised growth in 2024, do you just expect everything to rapidly trend up or there any particular recovery areas of acceleration areas that you expect to drive that?

GEORGES ELHEDERY: I don't think we have a specific business line split to call out. It's going to be more a geographic split. Areas such as south and southeast Asia today are growing fast. Areas such as Hong Kong and China. The outlook is now one for growth, but areas in some of the western parts of the world, where we still have more subdued economic conditions, may see a slowdown. So it's probably more a geographic evolution than a business line evolution.

We remain committed to growth, but we're not changing our risk appetite, so we're not going to chase loans for the sake of growing for growing. We're going to just adapt to client needs with our stable risk appetite. And if client needs are slower because of economic conditions being slower, we will grow less in that area and we will grow somewhere else where client needs are stronger.

RICHARD O'CONNOR: We will be optimistic. Companies always say it's the second half of the year. Ultimately, when you see what's happened in reopening in Asia, we think the conditions are there for a good bounce-back in the back end of the year. But trade volumes have been slow short term, for example, and it just takes time for some of the machines to gear up to a bounce-back in Asia.

MATTHEW CLARK: I guess an extension, then, is in terms of the mix effect of that growth being more weighted towards southeast Asia and potentially China and Hong Kong versus western Europe should be favourable to margins somewhat over time. Is that a reasonable assumption or conclusion to draw?

GEORGES ELHEDERY: In the UK, we have good margins. It's still a healthy franchise. So I wouldn't necessarily call it that way, but margins also reflect risk appetite.

RICHARD O'CONNOR: Asia is pretty expensive and there is a less of a fee culture in Asia than there is the west. So I hope you're right, but I think that would be optimistic.

JAMES INVINE, SOCIÉTÉ GÉNÉRALE: I wanted to ask about the Wealth business, please, and specifically the net new invested assets. So that number was up nicely year on year for 2022, but it's very volatile on a quarterly basis, and I think, a couple of years ago, HSBC set out the aim to hire 5,000 client-facing wealth advisors, so I was just wondering if you'd give us a bit of help on where that net new invested asset number might go over the next couple of years and how many of the 5,000 people have been hired so far.

GEORGES ELHEDERY: So on the first one, NNIA may be one of the important leading indicators for performance, but there may be a lag effect, and the same with deposits. Sometimes you grow your deposit base, but there is no value in deposits until you have a rate cycle that generates it. The same for NNIA. We're growing NNIA, but in a context where you need the underlying market opportunities to come. So it may have a lag, so we will keep tracking it. We clearly have internal targets to continue growing it, and we're taking market share from a number of peers and competitors, so this is not focused on one or the other of our competitors. We're trying to take market share. It's really broad-based.

On the 5,000 wealth advisors, I'll turn to Ming. I can say that we clearly are on track with our China private wealth planners in our insurance business, which is about 1,000 a year now that we're topping up. There's additional wealth executives – wealth relationship managers we're adding in Singapore. I don't know, Ming, if you have exact numbers to share here and something that we can share.

MING LAU: Thanks, Georges. The figure I would share largely relates to Pinnacle in China, where we've now hired in excess of 1,300 personal wealth planners for the Pinnacle insurance venture onshore in China. And look, I think 2023 is going to be a critical year for us, because it's the first year where we've rolled out the initiative but not been under Covid restrictions. So without the Covid restrictions, our wealth planners are now able to spend more face-to-face time with clients and, hopefully, selling some of the higher-margin products which are in the protection area versus the investment space. But look, early days, but that, I would say, in terms of investments and adding a number of wealth bodies, is what I would point to.

RICHARD O'CONNOR: And I would say we're on track for the overall 5,000 across the whole franchise. You wouldn't expect us to be ahead of plan, because Covid has slowed things down, so we'll pace it based on demand in the market and we'll let you guys know during the year, now Covid restrictions are off, how well paced that's going in the next couple of years, but basically on track.

On NNIA, I suppose you should think about it – you can define the wealth funds under management at $1.6 trillion, ex deposits $1.1 trillion. Think about it as a percentage of that going forward. And personally – and don't hold me to it – 5% plus per year is what I think you should be looking for of NNIA.

MARTIN LEITGEB, GOLDMAN SACHS: Could I just ask one relating to the outlook for NII for the UK ring-fenced bank? And, obviously, the ring-fenced bank benefited from an influx of deposits since the pandemic, and I was just wondering how you were thinking about that deposit base going forward in terms of scope for accretion and migration. And, related to that, I think some of the hedge capacity could have been within the UK ring-fenced bank. I was just wondering is the hedge capacity now fully utilised or is there scope to increase it?

CARLO PELLERANI: Hi, Martin. So, answering your second question first, yes, some of the hedges that we have undertaken have been in sterling overall, not all necessarily in the ring-fenced bank but, let's say, in sterling as a currency, and there is some more capacity, in particular in terms of extending the duration rather than the quantum, which will reduce the sensitivity to the downside.

In terms of dynamics of NII in the UK, I guess there are two effects. The first one is the competitive environment in the UK is less than the competitive environment you would have in Hong Kong overall, so you have a little bit less of the dynamics you would have in Hong Kong in terms of migrations and so on and so forth. We have started to see some competition for deposits in the UK, in particular for those institutions like building societies that are a bit less liability-rich. Most of the large UK banks have significant deposit surpluses on the back of ring-fencing, so the pressure is coming more from the other players.

What I can say is that until now we have had passthroughs of less than 50%. In our central assumptions from this point on we will see those trending towards 50%, which implies marginally higher than 50% from this point on. That is the assumption. It's going to be dependent on a combination of what happens in the market and what happens with competitors and so on and so forth.

GEORGES ELHEDERY: So one thing I would add is we have a variety of propositions in the UK – we have accounts that pay about 5% in HSBC, we have accounts that pay up to 7% if you lock the funds in first direct, but the instant access accounts will be paying much less, even if it's some level of interest, so the customers can choose.

We need to give them a little bit of time to see if there's a lag effect, but, obviously, the higher the rate, the more constrained the terms and conditions, the more restricted in terms of blocking the funds and access to the funds, etc. But you do have to factor in some lag effect in terms of that migration in some of these customers, which is in our forecast, by the way.

MAGDALENA STOKLOSA, MORGAN STANLEY: I've got two. I'm going to go back to the China reopening and the activity upside because I hear you from the perspective that it's slow; it's gradual. But if we assume that, let's say, even the movement of people between China and Hong Kong moves to 25%, 50% of what it was pre-Covid, where are we going to see it? Are we going to see it within the Hong Kong retail business or the payments side or are we going to see it on the commercial side from the perspective of trade finance that you've mentioned right in the beginning? So where should we look for that as it comes through.

My second one is on Global Markets, so the forward view on your revenue capacity, particularly when it comes to the FX business, which you've done very well with, particularly in 2022, and also any views of the DCM activity globally. Do you see that we're seeing green shoots there? Thank you.

MING LAU: I would say the China reopening would be broad-based, both impacting the retail side of the business and also the wholesale side, retail particularly. We used to be at 50 million visitors from China every year. Through Covid, the lack of those visitors essentially had an impact of reducing the number of new account openings we would have every single year. So, assuming that that starts to recover back to the levels of pre-Covid, we should expect to see an increase in terms of number of accounts on the retail side, which would benefit not only retail banking but I think also have an impact on the wealth side of the business.

And then I think, from a broader perspective, on the wholesale side of the business. Look, naturally visitors coming back to Hong Kong is good for the economy. And if you think about the tourism and the service sectors, which have been materially impacted by the lack of visitors into Hong Kong, one would expect a pick-up in terms of things like the SME sector and just broader generally on the trade side from a Hong Kong perspective.

So I think it will be pretty broad-based, but I think the impact will come through gradually and will probably be more prominent through the second half of 2023.

GEORGES ELHEDERY: And, Magdalena, Wealth Connect, for instance, has been severely affected by the border. Equally, if you look at insurance, the number of subscribers in insurance in Hong Kong coming from mainland China stops when people can't travel, and that can bring the revival in that space.

MING LAU: I think pre-Covid we used to see about 25% of our insurance sales to mainland-domiciled customers, so one would expect a pick-up in terms of insurance manufacturing and insurance sales. Wealth Connect – you typically do need to be in Hong Kong to open those accounts so, again, with the visitors coming back in, we would expect a pickup in terms of the Wealth Connect part of the business.

GEORGES ELHEDERY: On the second point, Foreign Exchange is one of the leading businesses. We're top two general in that space. The underlying for that business is effectively payments or trade. Essentially it's corporates doing payments or retail doing cross-border payments, as well as trade, any other FDIs, dividend repatriation, etc. So it's really servicing our core franchise.

That business generated in excess $1 billion a quarter. The outlook – I would say as long as we have a focus on growing out payments and our trade capability, FX is an automatic beneficiary of it because naturally they're a bolt-on service for any of these global payments or global trade.

In terms of DCM, I think we have two factors at play we need to watch. The first one is there's a clear revival of markets after a very subdued Q4. January has been very positive. February we need to see if that outlook stays. But clearly the reopening of the mainland China and Hong Kong economies will also see more activity in Asia, so that's a fair assessment to make.

This being said, you have to weigh this with the current rate levels and how much corporates or financial institutions want to borrow when the rates are at that level. We've seen a lot of borrowing during Covid that happened 'just in case' - they didn't necessarily need the money, but it was so cheap to raise the money; the DCM activity was brilliant with that. You are less likely to see that. How these two effects play out is yet to be seen.

ANDREW COOMBS, CITI: Two questions, one on hedges and one on IFRS 17. On the hedges, thank you for the clarity on the UK. More broadly, at the Group level, you talked about a third of the sensitivity decline is due to the additional hedges that you're putting in place. You're continuing to put those on throughout this year. I don't know if you can provide us any kind of sizing on that in terms of what the notional is, what the capacity is on the unhedged balances and what kind of rate do you think you're going to lock in on the basis that, if the Fed does cut rates in the next 12 to 24 months, this potentially limits the impact for you, so anything you can provide there would be useful.

CARLO PELLERANI: I'm not going to provide you exact guidance on that one. The amounts that we have done so far are not a bad indication of potentially what else we're going to do at this stage. We made a decision last year that we wanted to increase the overall stabilisation that we had. That is a strategic decision in the context of the rate environment. If the rate environment strategically changes, then we would reassess that, but that is the path that we are on at the moment.

RICHARD O'CONNOR: Let me answer another way. Our downside to 100 bps was $6 billion, $7 billion. It's now $4 billion. It should go to $3 billion or less. That's what we should be aiming for. It's not guidance; it's what you should look at us to do.

ANDREW COOMBS: That's helpful. On IFRS 17, I appreciate you're going to talk about this in a lot more detail in your upcoming – it's just coming back to your comment about a third of the insurance income, so about $1 billion. The reason I query it is because on page 99 of the annual report you give the first half numbers. You talk about a $300 million cost impact, a $400 million profit impact for the first half. So, if I just scale that up, you're looking at an annualised $1.4 billion charge, not a $1 billion charge on the top line. So was there anything particular in the first half 2022 numbers that mean that we shouldn't necessarily be reading from those?

RICHARD O'CONNOR: You should check the market impacts, which were very substantial in the first half and strip that out. But the number we gave you when we did the first IFRS 17 impact, which was offset against non-NII, was the right thing to do. We will tell you the line items and get the line items right going forward in March, and then May. There's no change on magnitude. We'll just give you more guidance as to how to better model this. You'll get the model really better at Q1 onwards, but we'll transition at the seminar on 9 March.

ANDREW COOMBS: Non-NII will go up by $2.2 billion, but then down again based on…

RICHARD O'CONNOR: That's correct, exactly. We have to thank you and apologise for a fiddly first half, but we'll get there.

GUY STEBBINGS, BNP PARIBAS EXANE: The first question was a broad question on costs and managing costs as a new CFO into the business at this particular period. It's obviously a high inflation environment. There are opportunities out there in terms of leaning into China. You no longer have the flexibility of the CTA, if you like, and you've got an investor base which is pushing you to be very diligent on costs and people in this room no doubt pushing you to be very diligent on costs.

It strikes me it's a pretty tough environment, taking that all in the round. I appreciate the comments around transformation. That might be a bit less going forward than the last couple of years, but any high-level comments on how you manage to factor in all those competing forces? Because it does strike me as quite difficult.

GEORGES ELHEDERY: So, yes, it is difficult. I'd be untrue if I didn't say that it is definitely a challenge. It's a challenge.

The couple of things I want to share – first, it's not a challenge that I'm bearing on my shoulders because all the Group Executive Committee are committed to the same journey, so I'm somewhat the custodian and the enforcer of the cost discipline, but the whole cost discipline doesn't just rely on my shoulders. Everyone is doing their part at the GEC. Cost discussions take place at every one of our Group Executive Committees. We track it very closely. We identify any issues that may pop up, and we've planned for what we guided towards. So this is not an aspirational target. This is a target against which we've planned.

Obviously, your question will be, 'What about 2024?' and, yes, that process has started already, but we're not yet in a mode where we can communicate about it, but we'll be planning around that. But it ultimately boils down to making hard choices. There are always things in a very large bank like us that we can decide to drive efficiencies from or that we decide are a marginal impact to our franchise. And, yes, had we been extremely efficient, you would say, 'Where else would you look?' but there are still areas where we can look in our current setup for additional cost saves.

MANUS COSTELLO, AUTONOMOUS: Can I ask about the decision to present the numbers on a legal entity basis going forwards? Because it seems somewhat curious, given that you spent much of the last year trying to convince shareholders about the interconnectivity of the group, that you're now presenting numbers on a subsidiarised basis. I wondered if you could elaborate why.

GEORGES ELHEDERY: This doesn't change at all the whole strategic consideration of the interconnectivity. First, we do report legal entities because most of these legal entities actually have public accounts with public records so we're not adding work; we're effectively taking work off somewhere, creating some efficiencies by not having to recreate regional reporting when we already have legal entity reports and Group reports. So we've just taken a layer out.

But more fundamentally, because obviously it's easier for us, we had two main issues. When we reported the Europe region, it was highly unrepresentative of how we run Europe because the ring-fenced bank, the non-ring-fenced bank, and the rest of Europe, including the holding company, which is a cost-bearing entity, are all mixed up, and are not representative of the different dynamics you can see, and what ring-fenced bank behaviour is versus the non-ring-fenced bank.

And then the second one is North America, where effectively Canada was lumped with the US, and, with the sale of Canada, we felt, 'Let's start now already giving more clarity on what is the US without Canada because Canada will be stripped out'. So that is a nice segue to have an understanding of the US evolution, as part of the pro forma of North America without Canada. Those are the main regions. By all means, you should not read at all the fact that – we remain absolutely committed to our DNA, which is connecting East and West and working on global interconnectivity.

RICHARD O'CONNOR: The principle is you should report how you manage, and Europe as an entity was not how we managed, and increasingly so in HNAH, increasingly so in Latin America with Mexico. So by doing it on a legal entity basis – it's how the Executive Committee manages; it's how the Group manages. So we should report to you how the Group manages, and that was the principle.

And whilst we're doing IFRS 17 and getting rid of below-the-line items, we thought we'd do it at the same time. So that was the thinking behind it. I know it's a pain in the proverbial, but, yes, that's what we thought.

GURPREET SINGH SAHI, GOLDMAN SACHS: My question is regarding credit cost. I see consensus modelling more than, and we are also saying top end of the guidance, so I'm hoping to get some colour from Georges regarding which geographical areas this year. We, while planning, thought that it would be contributing higher in terms of credit charges. And specifically in China, if Ming can comment, are we expecting more provisions from China and what can be the scenario to see that?

GEORGES ELHEDERY: Gurpreet, so where we provisioned at the end of last year – we're comfortable with that provision. We had indicated for 2023, 'the top end of the 30 to 40 basis point range'; we felt it would be cleaner and clearer if we just said 'approximately 40 basis points', because we're saying the range, but then ignoring the range because we're going to the top end of the range. We may as well just put a number that we think we will land close to. It's a probabilistic-based approach, so we not just building it up by making assumptions on various provisions we'll be taking across the world. So it's assigning probabilities of additional provisions in various areas of the world that landed us there.

The areas we need to watch, we certainly continue to watch China real estate. As I said, we think we're well provisioned and we think the outlook has improved, but we continue to watch that space. We need to watch some of the slowdown in the western economies, particularly places like the UK. There is an economic slowdown, still high inflation, high interest rates, erosion of cost of living, cash flow issues for some of the smaller corporates. So yes, there may be pressure on the smaller corporates in the UK which we need to watch closely. No indicators yet, but more pre-emptively being cautious and saying that there could be some issues there.

I think the retail portfolios have been resilient and are likely to remain resilient, and this is mainly due to the composition of our portfolios. So in the UK, 90% of our portfolio is mortgages with lower than 90% LTV, with good stress test on the early payment capability of the borrowers, so highly resilient. Hong Kong mortgage, you're probably familiar with, but it's mostly guaranteed above 60% LTV.

On the unsecured, we haven't seen any signs of stress and, if anything, it's not growing, because people are not borrowing additionally at these rates. And it's small in all cases, so I wouldn't be too concerned with this area. I would continue looking at the smaller corporates that are suffering from inflation and cash flow issues.

RICHARD O'CONNOR: I'll just add two things. Last year, we were quite fortunate. We didn't have what we call any tall trees – i.e. big one-offs. In China CRE we had a number of impairments, as you know, but that was quite broadly spread. If you look on a rolling-five-year basis, you do have years where you have tall trees, and there's nothing which suggests we will have this year, but they do happen. And when economies come out of difficult times, generally ECLs are a lagging indicator, so that's why I think we're quite conservative with our guidance. If we're overly conservative, then that's fine. We'd rather it that way than the other way round.

AMAN RAKKAR, BARCLAYS: Two questions, please. One is on your loan-to-deposit ratio. I think it's now sub-60%. It reflects a massive injection of deposits over the last three years, and this has driven an excess liquidity position that's become extremely lucrative for yourself and other banks and a big source of earnings for you now. What's the long-term outlook for the loan-to-deposit ratio? Where do you want to run the business at? Indeed, how do we get there in terms of loans and deposits? Because there's a lot of focus on the emerging deposit dynamic globally, and it could include things like outflows. How do you think about that?

GEORGES ELHEDERY: Aman, we're not specifically targeting an LDR. What we're targeting is medium-term loan growth of mid-single-digit. And for deposits, we want to have a leading proposition and remain competitive, but you've probably already seen we're not going to be paying above market to attract deposits. So we will be within the market average of deposit growth, whereas for loans, we have medium-term mid-single-digit growth. Where does this take the LDR is not something we really track. It's not necessarily a leading performance metric for us.

RICHARD O'CONNOR: The way to think about it is mid-single-digit loans and possibly a bit more, and we will defend our deposit franchises in our home markets – Hong Kong and the UK – as you've seen in Q4, but we'll retain our very strong franchise, but I wouldn't be that bullish with deposit growth over the next year or two, because we had this massive growth in deposits. Some of that will flow out of the system over the next year or two, but I think you should probably think deposits broadly stable and loan growth at that mid-single-digit and, ideally, slightly above over the two or three years.

AMAN RAKKAR: I guess the observation is that I think banks need to probably articulate a deposit strategy in a way that they didn't for the last decade, because they're now worth something in a way that they weren't beforehand.

RICHARD O'CONNOR: Well, transaction accounts, consumer, wholesale, every single day of the week. That's for us.

AMAN RAKKAR: There's a second question, and I appreciate this might come across a bit cheeky, but I'll ask you anyway. You've been transformed by rates. You've declared yourself as the most rate-sensitive bank in the world. Your RoTE profile is night and day from what we were used to seeing over the last decade. You arguably are benefiting from peak NIM, peak NII. I think there's a big liquidity tailwind that you're currently enjoying. Extremely capital generative, operating with a surplus capital position in short order. You've got a Canadian windfall. There's sensitivities around you returning that capital to shareholders. Why aren't you more aggressive on M&A? You've got a potentially generational opportunity to buy a wealth manager at a distressed multiple. Why aren't you? Why don't you want to be the Asian national champion for wealth management and wealth assurance?

RICHARD O'CONNOR: In short answer, we're not very good at M&A, so let's do organic.

GEORGES ELHEDERY: Look, what we did say is we want to do bolt-on M&A that increases our capabilities, in particular in Wealth in Asia. It is unlikely we will be interested in other areas, but Wealth in Asia as bolt-on M&A is important for us. So that's the parameter we're looking at, but that bolt-on M&A, what we've done is in the $0.5 billion to maybe, call it up to $2 billion. This is what we call bolt-on. It can be done through our capital generation. It does not necessarily change our profile in terms of distribution both on share buybacks or on dividend. But, yes, these opportunities, we continue looking at, but there are not necessarily many opportunities.

RICHARD O'CONNOR: The ones we've done in the last couple years have been $0.5 billion or less. I would point you in that direction.

ALASTAIR RYAN, BANK OF AMERICA: I'm going to disagree with Manus as well. I really like the legal entity disclosure and regional liquidity. Page 209, it's a very useful regional entity disclosure. The LCRs and NSFRs, they're off the chart for HSBC. They're just unlike any other bank, and I think you'd find it quite hard to explain just how much better your deposits are than other banks in terms of the quality of them. It's just coming back to this. I don't agree on the peak NIM either, but that's by the by, but just coming to how you think about pricing, it's almost one for Carlo. Really, if your LCRs are so high and your NSFRs are so high, you've got an ability to choose to just not price up and see deposits leave and be extraordinarily relaxed about that, I think. So that's the question. Is that the case? It's not what you will do, because it's a set of commercial decisions, but that looks like a lot of flexibility. 226% LCR in the UK is just peculiar.

CARLO PELLERANI: You call it peculiar, we call it competitive advantage. Indeed, historically, HSBC has attracted a lot of deposits, and I would say, on the previous question on loan-to-deposit ratio, what we have found is we are a very defensive bank for the street, so we end up attracting deposits when others perhaps aren't. So if you move away from the vagaries of quantitative tightening, you'll see us also absorbing more or less deposits, depending on what happens in a different market.

So two years ago, we established a strategy to look at the liquidity in each of the entities and strategically define how much liquidity we wanted in each of those. And the strategy has three legs, which I might have described before. And the three legs are deploy, invest and reduce. So we looked at how much liquidity we want to have in each of the entities and then we see the surplus and then, with the surplus, we decide whether we deploy it – i.e. what is it that we can do to incentivise for that excess liquidity to be deployed in the businesses? So we provide pricing incentives. It affects the pricing of loans versus deposits, and so on and so forth. To your point, it allows you, in the overall pricing of deposits, to be perhaps more aggressive than otherwise you would be, but it's not the only consideration for deposit pricing.

Invest is at the margin. If you have the liquidity, what is it that you can do without changing your risk profile in order to generate a little bit more? And then we had a leg which was reduce – i.e. incentivising more actively reduction by providing alternative products to clients, movements across the group. With the new rate environments, we have de-emphasised significantly the reduce leg, for obvious reasons, but we will continue to actively look at it. It's another nice problem to have. We end up attracting quite a lot. In this environment, it's a good thing.

RICHARD O'CONNOR: Let's be very clear, though. In our home markets – Hong Kong first and the UK second – we look at the franchise as well, so we will defend and ensure that, in Q4, we will defend our home markets where we need to.

RICHARD O'CONNOR: I know you had another question, but we'll take that offline and we'll wrap up. Thanks a lot, everyone.