HSBC

Transcript

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Fixed Income Call

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Faisal Yousaf, Group Treasurer
Richard O'Connor, Global Head of Investor Relations
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Non-HSBC participants:

Lee Street, Citigroup
Robert Smalley, UBS
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Ivan Zubo, UBS

GEORGES ELHEDERY, GROUP CHIEF FINANCIAL OFFICER: Thank you, operator. Hello, everyone. Thank you for joining us. I'm Georges Elhedery, I'm Group CFO. And I'm joined on this call by Fas Yousaf, our new Group Treasurer; Richard O'Connor, our Global Head of Investor Relations; and Greg Case, Head of Debt Investor Relations.

I'll speak about a couple of items relevant to this audience, and then Fas will give you an update on the balance sheet, and after which we'll go straight into Q&A.

I'll keep the opening remarks relatively brief, as I'm sure you've had a chance to digest the results since we published them in early August, and I won't be referencing any slides as we go through this, but there is a fixed income investor deck on the IR website.

So, we've announced a good set of second quarter results, the annualised return on tangible equity for the first half stood at 22.4%, or 18.5% if we exclude the provisional gain on SVB U.K., and the reversal of the impairment of the sale of the French retail business.

Revenue was up 38% and we've seen growth in all three lines of business. Despite the inflationary environment, cost growth in the quarter was restricted to 1% compared to last year's second quarter, and based on our cost target basis, we remain on track to meet our 2023 cost target. The ECL charge was $0.9 billion, 35 basis points of gross loans. This includes circa $0.3 billion for our Mainland China commercial real estate exposure that is booked in Hong Kong. And finally, our CET1 ratio remains strong at 14.7%, which allowed us also to announce an interim dividend of $0.10 per share, and a second share buyback of up to $2 billion to be executed in around three months.

So with that, I'll hand over to Fas. Fas, over to you.

FAISAL YOUSAF, GROUP TREASURER: Thank you, Georges.

Hi, everyone. I'm Fas Yousaf, Group Treasurer. I'm excited to be here today and looking forward to engaging with you all over the coming weeks and months.

Firstly, before I move on to the Q2 update, I wanted to give you a bit about my background. I've been at HSBC for over 22 years, in that time spanning many roles across Finance and

Risk, most recently as Global Head of Traded and Treasury Risk. I'm excited by the new challenge and I'm looking forward to further shaping and delivering the ambitious treasury agenda that we have here at HSBC.

Coming back to the second quarter, our financial resources remain in solid shape. As Georges mentioned, our CET1 ratio was 14.7%, flat on the quarter, 3.8 percentage points above our MDA level. Attributable profits added 1.8 percentage points to the ratio, but were fully off set by the dividend accrual for the second quarter and the first quarter buyback. Our CET1 ratio remains above our planned operating range, which to remind you is 14.0% to 14.5%. Albeit the current buyback is expected to lower the ratio by about 25 basis points. And additionally, we expect the re-recognition of impairment of our French retail business will further reduce the ratio by approximately 25 basis points. We expect to recognize this loss in the second half.

With respect to liquidity, remember that we primarily manage liquidity at individual legal entity level, so our liquidity story is more complicated than the Group LCR. We show the LCRs of our major entities on slide 14 of our fixed income investor deck, and I would urge you to note the strong ratios, all of which are above the group ratio of 132%, demonstrating the conservatism that's baked into our group LCR calculation.

In high level terms, we have $796 billion of high-quality liquid assets on the balance sheet, of which over $300 billion is in cash. Our funding position remains enviable with a loan-to-deposit ratio of 60%, giving us a very significant deposit surplus. Our MREL ratio was 31.2% of RWAs, which is 4.8 percentage points above our 26.4% requirement, and we expect to continue to maintain a prudent buffer over that requirement.

On issuance, starting with HoldCo Senior, well we've issued just under $16 billion so far this year, after the $3 billion issuance in August. We have a plan of $17 billion to $20 billion for the year and currently expect to be at the lower end of that range. As such, we have limited further needs and expect negative net issuance in the second half.

Of course, I would not rule out pre-financing for next year in Q4, but this would be a decision taken closer to the time.

In terms of Tier 2, we have issued $3 billion so far in '23, and that's against the plan of $4 billion to $5 billion, and again, we currently expect to come in at the lower end of that range.

Finally, we came into the year with relatively modest AT1 needs, only around $2 billion and covered the need in February. We've announced the call of our AT1 callable this year, totalling $4 billion, and so we will see another year of net negative issuance in this asset class.

Overall in summary, our profitability, capital, funding and liquidity position leave us well-placed and our business model offers bondholders one of the most diversified banks in the world.

On that note, let's open the call up for Q&A. Operator?

OPERATOR: Thank you. Our first question comes from Lee Street. Your line is open.

LEE STREET, CITIGROUP: Hello all. Thank you for doing the call and thanks for taking my questions. I have three for you.

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OPERATOR: His line has dropped, one moment please.

FAISAL YOUSAF, GROUP TREASURER: Okay. Maybe we can get Lee back. Can we take the next call?

OPERATOR: Yes. Our next question comes from Robert Smalley. Your line is open.

ROBERT SMALLEY, UBS: Hi. Thank you very much for doing the call. I just wanted to ask about capital generation, and I know in your fixed income presentation you put that first and foremost, thank you for that, I think it's an underappreciated credit metric. Could you talk about what you think the realistic running rate for capital generation would be over the next several quarters? That's number one.

Number two, do you think that we're kind of at peak levels there? Or do you see any kind of expansion in the capital generation rate?

And then three, if you talk a bit about the experience in the U.K., you saw a bit of margin expansion, doing a little bit better than peers. Just what's going on in the general environment, margin-wise? And then if you could address credit quality, I'd appreciate it. Thank you.

FAISAL YOUSAF, GROUP TREASURER: Okay. Thank you very much, Rob. Let me start with the capital question. So we are in a position, as you will have seen where we are very capital generative.

We guided to an NII for the full year of greater than $35 billion and that's updated this half. We are not guiding for 2024 at this stage, but all of the metrics, from our perspective, look very positive for the forthcoming years. And we are working to ensure that we have stable NII for the future. So there are various things that we're doing in that regard and perhaps I'll call out just a few of those.

So first of all, we have, as you will know, been working on a program of structural interest rate hedging. That is progressing well and you will have seen that our sensitivity over the half has come down from where it was at the end of '22 at around $4 billion for 100 basis points move down in rates. That has come down to $2.6 billion. There are various factors that drive that, but about a third of that number is down to our structural interest rate hedging program, and we'll continue that program over the course of H2.

We're also working on diversifying our revenue base, so we're moving through a number of initiatives to generate greater fee income, and you will have seen that in the equity call at half year. So overall, I would say from a capital generation perspective a very positive outlook.

Perhaps I will pass to Georges to talk about the U.K. and the U.K. market, if that's okay.

GEORGES ELHEDERY, GROUP CHIEF FINANCIAL OFFICER: Sure. Thanks, Fas. Thank you, Robert.

I would also highlight in the capital generation, as an addendum to Fas's point, the intended sale of our Canadian business, and you may have seen very recently the Competition Bureau in Canada giving the go-ahead. Obviously, additional regulatory approval and ministerial approval are required, but that sale should provide us with increased capital, which we've already indicated that of an amount of $9-10 billion, we will use $4 billion of which as priority use for the special dividend of 21 cents per share, and then the rest would just become excess capital available for share buybacks or other capital actions.

Specifically on the UK margin expansion, the first thing I want to highlight, Robert, is very important – that we are passing through to customers the majority of the rate increases that we have seen of late.

In particular, we've passed to our instant access retail saving accounts more than 70% of the most recent increases we've seen in the UK in GBP. So, therefore, it's very important to position this. The overall pass-through on some of these instant savings accounts now is close to 50% on a cumulative basis.

So, the reason why our NIM has performed compared to other peers – and I'm only going to give you some elements. Obviously, I cannot comment on other peers.

The first element is we have a materially smaller fixed-rate consumer lending book, which, in the market, had suffered some reduction due to customers repaying some of these consumer loans. We did not have this dynamic manifest in our books.

The second one is that we continue to have a very strong franchise in deposits – and has therefore helped us not have to pay up for some of the flighty deposits. And, as a reference, our term deposits remain a small, single-digit percentage of our overall portfolio.

And the third thing to call out is also the fact that our large mortgage book with a growing market share in mortgages – our new business market share is just shy of 10% against the back book market share of the mid-7%s – is giving us additional impetus, if you want, on the NII, given the way mortgages have been struck.

So these are some of the metrics that have allowed our NIM to perform as you've seen in Q2. A word of caution, though – we do believe that, at these levels, we're probably going to see a more stable NIM than any additional expected increases in this space. Thank you, Robert.

ROBERT SMALLEY, UBS: Thanks for all the detail. It's greatly appreciated.

RICHARD O'CONNOR, GLOBAL HEAD OF INVESTOR RELATIONS: Robert, apologies. You had two other questions there – credit quality UK, which I'll take.

Look, you saw in Q2. UK credit quality went back to normal if you look at the basis point charge, and so it's actually been better than some, or at least some commentators would say. Two areas where we are watchful: the mid-market segment and our early warning indicators on areas like mortgages or cars, but generally, UK credit quality is bearing up pretty well in a tough economic environment, but I'd say the charge very much for Q2 was at a pretty normalised level.

There's two other quick points on capital generation, Robert. Look, you'll clearly be aware of the building blocks with guidance for mid-teens RoTE. We were above that in the first half. That excludes, for example, Canada gain, and also our guidance for, short term, pretty cautious on loan growth versus our medium-term mid-single digit growth, for obvious reasons – pretty muted loan demand in, for example, Hong Kong and the UK at the moment. We're not bearish longer-term, but certainly near-term, that will be the case.

You've got the consensus on the website, and that's up to date, so you've got all the building blocks there. The one thing I would say is, clearly, the associate income doesn't flow through automatically to capital. Obviously, the dividends from the associates, which are public – and you can get them off Bloomberg in five seconds – do flow into capital, so you just need to make that adjustment along with other adjustments as you do your capital model, okay?

ROBERT SMALLEY, UBS: Great. Great. Thank you.

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: Thanks, Rob. Next question please, Julie.

OPERATOR: Thank you. Our next question comes from Lee Street. Your line is open.

LEE STREET, CITIGROUP: Hello, all. I'll try again. Three from me, please.

There have been a lot of changes in the group structure and things you've sold and the like over the last few years. Just any areas, at a broad level, where you think the group's structure can be improved, as you look out from here?

Secondly, welcome to the incoming new treasurer. Any areas where you think there's scope for optimisation within the HSBC liability structure?

And then a more detailed one to finish – just why run such a large MREL headroom at 480 basis points? Is that a mix of how it works across each individual resolution entities, or just why is that so large? They would be my three questions. Thank you.

FAISAL YOUSAF, GROUP TREASURER: Okay. Thank you very much, Lee. I think I'll probably start with the treasurer question, and then go into group structure, and then the MREL.

So, I officially moved into role on 1 July. I'd start by saying, look, I'm very familiar with HSBC, having been here some 22 years, as I said earlier. The strategy that I will adopt as Group Treasurer will be consistent with that of my predecessors, so there's no radical change that we'd expect to see, certainly in the short term, and our strategy is entirely aligned to the overall Group strategy.

From my perspective, probably, I've got four high-level priorities that I would call out. The first is really protecting and safeguarding what is a very strong capital, liquidity, deposit base and an overall balance sheet, and that's working with our global businesses and global functions in order to do that.

The second is really around 'optimise' and 'enhance'. So, what I want to do is apply a commercial lens to optimise where we use our financial resources across the organisation to benefit shareholders, investors and the like.

The third area, which is ever-present, I think, is regulation, and we've got a substantial programme of regulatory change that we need to deliver on, and that's a priority. And I suspect we'll touch on a little bit through the course of the call, but we've obviously got our commitments in terms of resolvability and recovery, and the legacy stack is one area that I'll be very focused on as I move through the role. We've got LIBOR cessation as well, which is another area of regulatory change, and the overall Basel 3.1 framework as well.

The fourth and final bit that I would call out is technology and analytics, so that's going to be an area of focus for me. I will be looking at optimisation, digitisation and making the best use of technology and advanced analytics within our treasury capabilities at HSBC.

So, to go on to your specific question about the liability structure and whether there's scope for optimisation of the liability structure, it's something we'd always look at and I have looked at over a period of time. There's nothing that I would call out, obviously, at this point in time, but we'll continue to look at that as we go ahead.

Equally, in terms of the group structure, as you allude to in your question, we've made a lot of changes over the past two years with the disposal of the French retail business and of our business within Canada. Add to that the restructuring in Oman and the completing of the disposal of the Greek business as well and the announcement that we will be winding down our operations in Russia. So there's a lot of things that we've been doing in a very short space of time. We'll continue to look for opportunities, but we'll obviously announce those as and when we go along.

Finally, in terms of our MREL and the MREL structure, there are various drivers for that. At the moment, the overall buffer that we run is around 4.8 or which 3.8 is CET1.

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: So, Lee, yeah, so I think it's fair to highlight we have a 4.8 percentage point buffer right now, but important to note that 3.8 of that is CET1. That's effectively the buffer that we're running in CET1, and right now as well, you'll note we're operating at 14.7, so we are operating about 50 basis points above the mid-point of our range, though, naturally, that buffer will likely come down modestly over time, and we'll be primarily still CET1, and we'll run a small buffer in other MREL instruments.

LEE STREET, CITIGROUP: Alright, that is very clear, and thank you very much.

DANIEL DAVID, AUTONOMOUS RESEARCH: Hi. Good afternoon. Thanks for doing the call. I have three as well. The first one was just following on from what you were saying about optimal levels of capital. So I guess you've been shrinking that Tier 1 stack with calls larger than you've re-financed, and I guess I'm just interested – is this level of Tier 1 where you see yourselves longer term or could we maybe expect you to increase it back to more historical levels when double leverage was a bigger factor?

Secondly, I guess, on the legacy – it would be remiss of me not to bring it up. You've done an awful lot, and that's been acknowledged. I guess the one part of the stack that I think you haven't touched yet is the make-whole bonds, so the 10.176 and the 5.844. I guess my assumption is these bonds have to go eventually. Is there something you're waiting for? Is there something we should be watching out for? I guess is it rates peaking? Is there anything else that we should be looking at? I'm just interested to hear your thoughts with regard to that.

And then, finally, just on LIBOR, I guess you've got a number of AT1s with fallbacks which are defined, but I'm just interested to hear how you're thinking about those, particularly the New York law AT1s, which have got problems with the reference to mid swaps. Any thoughts there would be appreciated. Thanks.

FAISAL YOUSAF, GROUP TREASURER: Okay, thank you. Thank you very much. So perhaps start with the Tier 1 or AT1 stack. Our funding plan for this year in senior holdco[?] was for $17-20 billion, as I said, and in AT1 was $2 billion, and in Tier 2, was around $4-5 billion. Now, we're very close to meeting those levels and, as I said right at the beginning, we'll be pitching for the lower end of those ranges. On a go-forward basis, I think that's broadly where we will be looking to issue. I'd expect a fairly stable funding plan over the period.

Now, if we focus in and zoom in onto the AT1, we've been net negative in terms of issuance this year, and indeed for the last couple of years, so this year, we've issued $2 billion, but called and redeemed around $4 billion. On a go-forward basis, I think we will be, by and large, with all things being equal – RWAs and the like – net flat in terms of our issuance for AT1. So that's probably the best guidance I can give you at this stage.

Onto legacy and the make-whole piece, it has been a considerable focus for us, and we've reduced the legacy stack by around $6 billion over the past couple of years, albeit we have still approximately $8 billion to go. We would like, for the legacy Tier 1 make-wholes, just like the rest of the legacy stack, we'd want to redeem them if we can, but at a reasonable cost. The economics are extremely important for us, and we have a duty to our shareholders, and any actions that we take would obviously need to be fully justified.

As we've said on prior fixed income calls, the economics here aren't really ideal and, as such, we continue to look at the options. I think you can probably conclude, given that we've had – that these have been available to call for a little period of time, that the economics on the make-whole calls that we have are not economic. So, we'll continue to look at it, but there's nothing more, really, I can add at this point in time.

Finally, on LIBOR, look, it's another area of focus for us. We've made some progress there, as you will have seen from the announcements in June. We want to work together with our investors to reach a solution that's mutually agreeable and in line with the regulatory requirements. However, in some cases, this is not entirely possible. In the case of the New York instruments, consent solicitation isn't an option for us because, under New York law, we would require 100% of bondholders to agree to any change. So, then, that makes those swap resets instruments a little harder to deal with. We'll look at options. We'll continue to focus on it, but that's where we are at the moment.

As you will know, in '21, we undertook consent solicitation on some of our Sterling and Singaporean Dollar English law securities. It was very pleasing because we were able to remediate the sterling ones. We got that passed. The sing ones weren't able to pass, but we've since redeemed those. So there are multiple actions we can take with this, and we'll look at all of them for all of the LIBOR-based instruments.

DANIEL DAVID, AUTONOMOUS RESEARCH: Thanks. Really clear. Can I just – just one point on the make-wholes? I guess you referred to the economics, and other issuers talk about economics in the round. Are you just referring to the day-one impact of buying these back, I guess, or is it a NPV of the future cash flows less the cost on day one? Is there something else to it?

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: Yeah, so we typically consider the transaction as a whole, so if we were looking to either exercise the make-whole or repurchase the bond, and in any case, we'd always look at the NPV, taking into account all the cashflows, and comping that against what we think our long-term cost of capital is.

As Fas mentioned, though, what I would say is, of course, is we're not absolutely clinical on that point. We are willing to take a loss and that's part of the broader conversation. It just has to be proportionate, and that's what we'll assess over time.

DANIEL DAVID, AUTONOMOUS RESEARCH: Understood. Thanks a lot.

PAUL FENNER-LEITÃO, SOCIÉTÉ GÉNÉRALE: Hi, team. Thanks a lot for the call. I just got – one of my questions has been answered. I just wanted an update. It's been a while since the end of the first half. What's going on in terms of China and Hong Kong real estate –

what trends you're seeing there. Are things getting significantly worse – just any colour that you can provide there.

Second, you've provided an ECL charge outlook for the full year of about 40 basis points. Have you – is there a guide that you can give us for what you think that's going to look like in 2024? I don't know if you've provided that.

And then, lastly, you mentioned the sale of France. I just wanted a quick update on that, where we are, what the timing now looks like and what the risk to that is. Thank you.

FAISAL YOUSAF, GROUP TREASURER: Okay, so I'll pass over to Georges for this.

GEORGES ELHEDERY, GROUP CHIEF FINANCIAL OFFICER: Sure. Thanks, Paul. So, on the China commercial real estate, as we indicated at the interim results, the piece that remains of a concern, of a more material concern, to us is the offshore piece, the piece that's booked in Hong Kong, and a portion of which is unsecured. So that is the one that remains a cause for concern.

We had, at the year-end, if you recall, mentioned a plausible downside scenario of $1 billion additional ECL. By the end of H1, we had taken, in aggregate, about $300 million against that portfolio towards that plausible downside.

I think, when you look at the events that took place in August, I would point, really, to two indicators. The first one is we continue to see policy measures being constructive and supportive of that sector, and we see these policy measures – practically every week, a series of measures that are meant to structurally and more sustainably support the sector going forward, which is a positive outcome. But we equally continue to see deterioration of the financials of some of the borrowers, and that deterioration is, unfortunately for some, happening faster than the benefits of some of these policy measures that may come in.

So, as a net, if you want, of these two, we're looking at it more cautiously now than we were in early August, and I would say the plausible downside we indicated at this stage we believe remains valid, we believe, in terms of quantum. We believe, though, that the probability of the plausible downside has increased following the events of August, and we continue watching this space, and we do expect indeed to give you additional guidance at the Q3 results in a couple of months.

On your ECL, so we indeed maintain 40 basis points for this year. We did factor in some of the possible adverse events that could take place in Hong Kong and the UK. We indeed are seeing those events in Hong Kong materialise, related to this China offshore real estate portfolio – commercial real estate portfolio, whereas we do see things more resilient, as Richard mentioned earlier, more resilient in the UK, and the indicators holding up quite well. This is why we were comfortable – we remain comfortable with the 40 basis points.

We haven't given any guidance for 2024. I can only point you to our through-the-cycle guidance on ECLs of 30 to 40 basis points, that range, through the cycle. We will be giving any further 2024 guidance when we give more granular guidance to '24. At this stage, we are only committing to a mid-teen return on tangible equity for '24 as the only guidance that's very specific to '24 on our results.

On the sale of France, so, look, as Fas mentioned, we continue to expect that we will have to reinstate the 25 basis point impairment, or $2.2 billion impairment, of that sale sometime in H2. We had initially communicated an ambition to execute it on 1 January. Obviously, the risks around that filing are there, but the main risks to call out is the process of regulatory approval. The transaction is more complex than the one we signed originally. It has more parameters to it, and therefore requires more evaluation and more time. But, as you would expect, the moment we see this to become a highly likely transaction, we would reinstate the impairment, and probably give more guidance at that stage as to more exact timelines.

PAUL FENNER-LEITÃO, SOCIÉTÉ GÉNÉRALE: Thank you. Sorry, so just to be clear, that you expect to potentially – if things stand as they are, you expect to take that charge in Q3. Is that right?

GEORGES ELHEDERY, GROUP CHIEF FINANCIAL OFFICER: Look, the expectations we can share is H2. It is probably premature to call Q3 versus Q4, but H2 remains a reasonable expectation.

PAUL FENNER-LEITÃO, SOCIÉTÉ GÉNÉRALE: Okay, and with new completion now, what, in H2 '24? Does it take that long or quicker?

GEORGES ELHEDERY, GROUP CHIEF FINANCIAL OFFICER: No. Initially, the ambition date for completion remains, at this stage, 1 January 2024, but obviously, that date is at risk of a delay due to the delays with regards to regulatory approval. We haven't given a new date, if you want, at this stage. We're probably gathering our thoughts now and assessing where we stand in September after the August holidays, and particularly also some of our regulators were on – their reviews, and we will be giving you more guidance on that at our Q3 results.

PAUL FENNER-LEITÃO, SOCIÉTÉ GÉNÉRALE: Okay, thank you.

GEORGES ELHEDERY, GROUP CHIEF FINANCIAL OFFICER: But we can now more reasonably expect a delay. I wouldn't be able to comment as to whether it's in H2 '24 or whether it remains an H1 '24 transaction. It's too early at this stage to make this description. Thanks, Paul.

PAUL FENNER-LEITÃO, SOCIÉTÉ GÉNÉRALE: Thank you.

FAISAL YOUSAF, GROUP TREASURER: Thank you, Paul. Julie, can we have the next question please.

OPERATOR: Thank you. Our last question comes from Ivan Zubo. Your line is open.

IVAN ZUBO, UBS: Good afternoon. Thank you. I just had a quick follow-up question on the legacies, and basically, thank you very much for mentioning the economics being the key criteria, but there's a very different economics on the 10.176 dollar legacy Tier 1, where the make-whole price is 130, and the sterling, the 5.844, where it's 106. So, should we look at this decision as a package, or could you potentially make a different decision on those different bonds? Thank you very much.

GREG CASE, HEAD FIXED INCOME INVESTOR RELATIONS: Yeah, I wouldn't ever rule anything out at this stage, Ivan. I think in terms of the economics, it's important to come back to that point that I mentioned to Dan earlier - the economics isn't just about the upfront hit. It's about funding it as well. So, we'll take into account the upfront cost, and then of course you get either the bleed or the benefit through the P&L over the period of time – effectively, to the par call date around 2030. So we'll bake it all in when we consider the economics.

IVAN ZUBO, UBS: Perfect. Thank you so much.

RICHARD O'CONNOR, GLOBAL HEAD OF INVESTOR RELATIONS: Thanks, Ivan.

FAISAL YOUSAF, GROUP TREASURER: Thanks, Ivan. Okay, so thank you very much, everyone. I hope this call was useful for you. If you do have any further questions, please pick up with Greg and the IR team. Thank you.