Edited Transcript

Interim Results 2017

Meeting with Analysts hosted by Iain Mackay, Group Finance Director

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HSBC

Iain Mackay, Group Finance Director

Welcome to everybody joining from Hong Kong. Good afternoon, good evening, actually, very good of you to take up some of your evening to join us, and, equally, to yourselves in London. I don't think there's any point in me babbling on with some preamble, so I think we'll just dive into the questions.

Richard O'Connor, Group Head of Investor Relations

With that, can we just say your name and institution, please, and we'll try and limit to two questions per person to start with and then obviously for a follow on we'll go around again at the end, okay?

Iain Mackay

Why don't we start with Hong Kong? Any questions from Hong Kong?

Gurpreet Singh, Goldman Sachs

Hi Iain, this is Gurpreet from Goldman. If I can maybe ask a question on Europe. The second quarter did see a good pickup in the profits sequentially, so can you walk us through what's there in terms of any underlying trends which are better in Europe maybe, some Corporate Centre things. And then, aside from that, how do you see the business going forward there?

Iain Mackay

So Europe was mostly a story about the UK, actually. So we continued to grow the mortgage book, so I think we've now got 20 brokers doing origination for us, not actually origination, it's sourcing borrowers as opposed to doing the underwriting and decision making. So we're now up to just over 55% coverage of the market as a whole and continue to grow the book in the UK, it continues to be done quite conservatively in terms of the underwriting standards, as you would expect.

Commercial Banking in the UK progressed somewhat and Global Banking and Markets had a strong quarter. So the outstanding feature, from a European perspective, was strong performance in Global Banking and Markets. In the second quarter, the only product lines that were down were Rates and Credit trading and they were, broadly speaking, down in line with what you saw across the rest of the market in that space. But excluding those two product lines, Global Banking products were up, Global Liquidity and Cash Management, Global Trade and Receivables Finance, Securities Services, Advisory M&A, we had good progress on Equities and we had a good quarter in FX. So the main driver of performance improvement in Europe in the half and in the quarter was Global Banking and Markets in terms of quantum, but good progress also made within Retail Banking and Commercial Banking. So I think that's the outstanding feature and all those numbers are obviously on an adjusted basis. When you look at it reported, Europe's got a fairly healthy chunk of costs to achieve coming through with a lot of the process re-engineering technology upgrades going on in this building, frankly, where a lot of Global Banking and Markets is driven from. But on the adjusted basis, it was very much a Global Banking and Markets followed by Retail followed by Commercial Banking.

Richard O'Connor

Also, you saw Corporate Centre swings quarter-on-quarter, negative in Q1, and some positive in Q2 as well. As Iain said, good loan growth and good deposit growth in Europe as well.

Iain Mackay

Okay, next question, we'll go to London this time. Tom.

Tom Rayner, Exane BNP Paribas

Can I just ask you on costs, Iain, the second half you've flagged $300 million of additional investment, also maybe the CTA sort of overshot by about $600 million versus, I think, original sort of indications. I just want to get a sense that we're not looking at the best part of $1 billion of what might become a sort of

overshoot on underlying costs as we move into 2018. And previously you have talked about the gross cost savings and the $6 billion of per annum savings I think you mentioned maybe being about 60% of what is ultimately achievable. And I just wonder if you can maybe talk about some of the moving parts going into next year, looking at the underlying inflation and investment, any incremental gross savings, and then possibly whether the CTA, is there any hangover from that? Is there any sort of residual costs which are rolling forward that we need to think about? Thanks.

Iain Mackay

Right, okay. So, on the last point, Tom, there is no hangover. This gets cut off actually before December 31st. So every two weeks we sit with Stuart, with the teams, mostly the teams that are sitting on the naughty step, which there are from time to time, and go through what it is that we need to accomplish both in run rate operating expenses, but also within, much more specifically, the costs to achieve, so the investment in realising the accelerated investments that we've done around process technology and other areas over the course of the last two and a half years. So we have a trajectory that we are managing month by month both with respect to the operating expenses and our headcount that are deployed on change projects, with a clear trajectory to wrap up all that investment ahead of the end of the year and to either remove the headcount that are on those projects – but to be clear, we have some of our best people working on those big change projects within the Bank and so what we are doing is ensuring that we have the capacity, through attrition and other actions, to ensure we can keep continuity for those people that have played a big role in delivering some of the change over the course of the last couple of years.

The same goes for our operating expense base. We've got a targeted exit rate of $7.1bn, $7.2bn. We've got a bit of work to do, as you saw. We're sitting at $7.4bn in the second quarter, we've got a bit of work to do in the third and fourth, but the commitment from the team and Stuart at the front of it, as the main cheerleader, is getting to that exit run rate and then demonstrating the continued discipline around the cost base going into 2018. So within 2018, sort of broadly speaking, we see inflation running in the range of around $600 million presently at the moment, we hit that exit run rate, but we've got carry over savings which would not have, per se, hit the P&L in 2017 that will pick up in '18, so programmes that are completing later in the year, and building line of sight to absorbing inflation and creating capacity for investment. What we talked about on Monday was recognising that we have built a little bit of momentum around revenue growth and there is a clear focus on continuing to invest in the capability and efficiency of the firm that, with a clear line of sight through the monthly, quarterly performance with good positive jaws, we would ensure that we're not starving businesses for the capacity to invest. So, this year, it's hitting the exit run rate and positive jaws; next year, it is trying to keep costs flat and continue to create capacity to absorb inflation and capacity for investment, but to leverage positive jaws to ensure we maintain capacity for investment and improvement in the firm.

In term of the CTA, we are going to hit the six billion in terms of saves. We will overshoot a little bit, and we've guided on this, through a billion in the second half. That incremental investment of $300 million, we've actually done a good chunk of it already. So the agreement that we reached with our North American colleagues was a) it's very much orientated around Retail Banking Wealth Management in terms of improving the capacity to serve in the US and then b) focusing on expanding market share in Canada, where we've got a good bank returning good results. But we've lost a little bit of market share as we closed down the Consumer Finance unit in Canada, so it's very much focused on re-capturing that market share and improving the service proposition. The agreement was reached on the basis that that work would be completed in 2017 so that the costs associated with that investment are investment as opposed to being built into the run rate of the Bank, and it is very much focused on growing revenues.

The other one feature in the first half is we clearly had slightly higher accruals for variable compensation on the back of stronger profits coming through, principally, Retail Bank and Wealth Management, but that's the story.

Raul Sinha, JP Morgan

Iain, can I have two, please? The first one on the buyback and the thought process behind coming to the 2 billion number. Could you walk us through how you actually arrived at the answer that $2 billion is the right number for the buyback?

Raul Sinha

The underlying reason for asking the question is, you've got a lot of surplus capital clearly building very quickly and, as far as I can see, the dividend that came back from the US after the stress test was quite material, $5.7 billion.

Iain Mackay

No. So let me walk through that. For us to do anything with capital surpluses they have to sit in the parent company, right? I can't call up the Fed or call up Pat Burke in the US and go, 'Pat, can you pay a dividend or a buyback for me?' He can't do it, right? And I've said we had over $8 billion surplus capital in the US, we got $2.5 billion back in our first dividend in 10 years from the US in April and that was on the back of the 2016 CCAR non-objection. In June, we got a no objection to our 2017 capital plan embedded within CCAR and that capital plan envisages more dividends being paid to the parent company over the course of the next 18-24 months, basically nine quarters. So we now have that non objection, we will pay dividends out in line with our capital plan, but the capital plan is approved not just with respect to amount but in timing. And when you construct these plans, you construct it such that you increase the propensity of getting the money out as opposed to going, right, we want it all in the third quarter of 2017. So we will get the balance of that six billion, give or take, out over the next couple of years.

Richard O'Connor

But that $5.7 billion includes the $2.5 billion in April, so you've got to net that off. So, $5.7 billion is really $3.2 billion going forward.

Raul Sinha

And the proximity of the $3 billion buyback that you've done so far this year compared to the $2.8 billion scrip pickup that you disclosed in the first half –

Iain Mackay

Coincidence.

Raul Sinha

That's just purely coincidence, right.

Iain Mackay

Yes.

Raul Sinha

Okay.

Iain Mackay

So it's exactly as Stuart said on the call. Our principal focus is investing capital to continue to grow the business. It is maintaining an appropriate management buffer, in line with our views of uncertainties that exist in the market, whether informed by geopolitics, regulatory, so on and so forth. Clearly, that is

beginning to normalise, but there are still a couple of things out there where everybody kind of just assumes that Basel IV goes away. I would love to fall squarely into that camp. I am a lot more optimistic than I was a year ago, but when you speak to regulators that sit in these meetings they don't fill you with optimism? We'll get there, the question is when and what is it that we get to. So we will retain some degree of prudence, from our perspective, in terms of just uncertainty around that.

The other component, we'll talk more about IFRS 9 in a couple of months. We've got a pretty good fix on what that range will be, but we want to complete the parallel runs and all the dress rehearsals and make sure that we've got a good set of numbers before we put them out in the marketplace. We can happily accommodate that within where we are sitting right now and then we'll look at buybacks as a capital management tool and that's what we've done. So how did we get to $2 billion? We sat down and had a discussion with our Board around a range of possibilities, looking at common equity tier 1, and all the things that I've just discussed and reached an agreement around $2 billion.

Raul Sinha

Just the second area was around the rate sensitivity, because your disclosure showed, I think, 2.44, which is slightly higher than what you showed last time. So can you talk about what was driving that and also, if you wouldn't mind giving us a bit more of a long-term view on how the balance sheet will respond to, let's say, interest rates going up by 100 basis points over a greater than one-year period. Just to get away from the sort of boilerplate disclosure but more into what is the real economic impact, as far as you can see, on returns.

Iain Mackay

The change in the sensitivity is largely informed by the assumptions around, for example, deposit betas, so what we've seen in a number of markets on the back of increases over the course of the first half of this year, how competition has responded to that, how customers have responded to that. So that's one of the assumptions that underpins it. It's not an insignificant assumption. But what the team is doing is, every quarter, we're sitting down and revisiting that sensitivity analysis. We're, frankly, trying to get to the point that we can build much greater refinement into how that sensitivity is built, by market, by balance sheet, basically. But it's a re-evaluation of some of the assumptions that underpin that and that's what driving it. One and probably the largest influence of it is deposit betas by different customer, by different markets, informed largely by how competition is behaving within those markets.

Raul Sinha

It's not balance sheet?

Iain Mackay

No.

Richard O'Connor

It's mainly the UK, which moved up on UK assumptions, so obviously you'll have your own ideas on UK rates. For us, you're used to, obviously, rolling 5 year hedges in the UK. Our Hong Kong balance sheet is short term, so what you see is what you get in terms of Hong Kong, so we're slightly different from other so-called UK banks in terms of that medium term, five-year timespan. You know, Hong Kong, you either get it or you don't.

Iain Mackay

So the other thing as well is, a question that's come up over the course of the last few months is this apparent disconnect between HIBOR and US dollar LIBOR and the peg mechanism has got a trigger at HK$7.85, at which point the HKMA acts and the rates normalise. I think we're sitting at HK$7.82 this morning and, you know, we put the chart in the results presentation but, you know, the FX trader supremo in this building, who happens to be called Stuart Gulliver, he knows the peg better than anybody, literally, and our view is that in the fourth quarter that HK$7.85 sort of looms on the horizon and then we

start seeing some realignment around rates in the HIBOR space probably going into – maybe coming out of the fourth quarter of this year, going into the first quarter of next year. And then that, over time, would obviously have an impact on the largest part of our deposit base in Hong Kong, which is HK dollar. But also what it may, you know, lead to is an opportunity to reprice some of the assets that sit within that balance sheet as well.

Raul Sinha

Is that very quick or is that –

Iain Mackay

No, it will be gradual. The other aspect which, you know, we reflected a good deal on is: what is the impact of the Fed or the ECB, for example, beginning to taper on QE and withdrawing some of that liquidity from the marketplace and is that what's informed some of our competitors in certain markets taking a much more aggressive stance now in deposit-gathering, in terms of paying for new deposits and in terms of recognition that that, you know, clears the TFS in the UK or whatever going away? Because that would draw liquidity and does that alleviate some of the pressure that we see in asset pricing right now and create the opportunity to reprice through the assets, which again, from our perspective, would be a very positive development. But I think there's a wider question around if this is managed very, very gradually, but you've got three big central banks in the world – four, having to do QE and they probably can't all do it at the same time and nobody really knows how that's going to work. But I think, from our view, if that were managed well by the various governors of the central banks, then we view that as a net positive for ourselves in terms of the strength of our deposit base that we sit on.

Alastair Ryan, Bank of America

Slide 30 of your deck, this is probably a little unfair because you are the Hong Kong Bank, but all your growth is in Hong Kong. That's great, because –

Iain Mackay

Well, it's Hong Kong as a booking centre as well.

Alastair Ryan

It's $41 billion of $62 billion, so Hong Kong's growing faster again, now they've picked up. It's your highest margin market, that's great, but the rest of the Group's not done a lot yet. You know, we haven't seen a lot of momentum coming out with everything else put together. Now, clearly, there's been restructuring going on, there's been currency, but I mean do the next 12 months look like that again, because Hong Kong's growing faster and, you know, there's problems elsewhere, or can you get more of a balance into the Bank? Because you have become quite Hong Kong-dependent again.

Iain Mackay

Yes, absolutely. If you go back, Alastair, and think about some of the logic – we'll call it logic – around some of the acquisitions that were done in the late '90s, early 2000s, it was around diversification away from Europe. You know, 20 years later, you look at this and go, well, that didn't really work, did it? But I think, at the same time, when you look at the specifics behind the Middle East and North Africa, there is a region that still has some interesting challenges. And one of the drivers in that space, for us, was – in Global Trade and Receivables Finance is we have done repositioning of the book around, frankly, exiting clients that just couldn't respond to our questions, from a due diligence perspective, around AML, for example. So that is a business that continues to perform well for us. It had a good first half, it had a very good first half last year, which means they've done pretty well in the first half of this.

But in terms of real growth, when you look at it proportionately compared to what the European businesses or Hong Kong can do, it's pretty small. And the US and Canada are relatively small businesses, but we saw small growth coming through from them and that's what we're going to see. If

we can see those businesses grow in Commercial Banking, Retail Bank, Global Banking and Markets and get some growth coming out of it, then that will be, you know, encouraging based on the strategic goals we've set for them. And Latin America is, basically, Mexico, right? And Mexico, as you all know, is part of the strategic focus, it's rebuilding, the numbers are still pretty small, but what Nuno and the team are doing is building it very much in line with the risk appetite. They've got a good grip on what's going on and it will build, so we're reasonably confident about the progress – in fact, we're very confident about the progress that Nuno and the team are delivering on in Mexico. And Pat and Sandra and the teams in the US and Canada respectively are focusing on growth, but it's just we are smaller in those markets and if the opportunity for us is there, we'll take it, but there's a strong focus on taking business on the balance sheet that we know is going to be profitable.

Richard O'Connor

And with the US you're still seeing the effect of the run-off, although that's now down to $1.6 billion. So that will be gone by the end of the year, then you'll see some modest growth in the US, I guess.

Iain Mackay

The facts are exactly as you've described them, Alastair. The encouraging bit is that we continue to compete very successfully in what is a very competitive region of the world in Asia, and come out on top in, you know, more than our fair share of the transactions that we're going after. So the continued strength and resilience of the Group in Asia, in what is a remarkably competitive environment, whether it is the Chinese banks and then, more regionally, the ASEAN banks, whether it's Singapore and Malaysia or the Australian banks, you know, that continues to perform very well.

Alastair Ryan

And part two of the one question, is it just on the UK then? How material can that be for you, e.g. mortgages? You could make quite a splash now that you've gone into part of the mortgage market you weren't in before, but then the UK market's going down the plughole, so…

Iain Mackay

Yes, so again, it comes down to, as ever, maintaining that prudence and quality around underwriting. So I think – and people will correct me, because I misspoke earlier in the week, but I think our share of volume in approvals was about 8%, just over 8% in the first half. I think we've got just over 6% of stock of the inventory of all mortgages. Our view is that within our risk appetite, with good quality selection in the underwriting process, we can grow that to double-digit market share. There's been a lot of investment by Antonio and John and the team in improving the mortgage offering in the UK. There's been a lot of effort put into ensuring that we see more of the market through the broker channel and that is working and it's working well. The team puts products on the shelf that are quite attractive in terms of fixed rates with good pricing around it, but the qualifying criteria for those are really incredibly strict in terms of the size of deposit you need to be able to afford, the affordability under stress and so on and so forth.

Where there is perhaps a slight change in tone first to second quarter is within the unsecured, the personal unsecured lending. Again, we've got a prudent stance. When you look at the quality of the customer which composes our unsecured portfolio, it is very high quality. Delinquencies are very consistent. But there is absolutely an aspect about lending more into a market which, if you look at the levels of household indebtedness, they're back at the levels of 2007 / 2008, and when you see what's happening on the high street and the numbers coming through on a monthly basis, it feels a little bit as if, you're getting to closing time and people are trying to get a few more pints in as opposed to going, you know, why don't we have a glass of water and walk home. So I think there's a need for a wee bit of caution around that.

Richard O'Connor

But in the UK we're seeing good growth in Commercial as well and obviously our customer base is internationally orientated and trading quite well in the UK.

Hong Kong.

Stephen Andrews, Deutsche Bank

Morning everyone over there. Could I just ask two quick questions, please? I mean, the one area where loan growth in Asia has picked up, as Alastair pointed out, is Hong Kong. I just want to dig into this in a bit more detail exactly why it is picking up, because it seems from the HKMA data a lot of it is for use outside of Hong Kong. Is it your experience that it's Chinese corporates deciding to borrow dollars offshore again, but rather than taking it to the mainland they're spending it offshore now? Because last time we saw this pick up, it was really carrying trade into the mainland. I'm just curious to know what type of lending it is this time. Is it long-term, is it short-term trade finance? Because it is a very marked, notable pickup from sort of down 5% year-on-year this time last year to up 14% and accelerating, so what is the lending? And then I've got a second question after that.

Iain Mackay

Well, I'll chat and Eva can jump in if there's more colour that we can add. Within Hong Kong, it is fairly short-dated stuff and recall that most of our network in Hong Kong is a branch of the Hong Kong and Shanghai Banking Corp. We have, as you can see, very strong funding and liquidity position in Hong Kong in HK dollars, Renminbi and US dollars. There is a good portion of that lending which is in US dollars. It is across a variety of customers, it's not all mainland China; it covers Hong Kong, mainland China and others who have their operations within Asia that need access to US dollar borrowing. It's all pretty short term in nature. I think, on the average, it's a year or less, so there's a lot of our focus is making sure that we've got a good pipeline. So a year or less is fine, but it doesn't last very long, so a lot of the focus of Gordon French and his team in Asia is making sure that we've got a good pipeline that continues to maintain the inventory within the balance sheet at the return levels that we like. It's well diversified, from a sectoral perspective, and it's pretty well diversified from a jurisdiction of risk origin, if you like, whether it's China or elsewhere. It would be completely inaccurate to say that we've changed our risk appetite in Hong Kong or, for that matter, anywhere else in the world. So it's very consistent, from a risk appetite perspective and from an underwriting standards perspective. Eva, I don't know if you'd add any more colour.

Eva Law, Chief Accounting Officer, Asia Pacific

No, I think, Iain, you've summed it very well and we have seen this increase in, you know, various sectors, including some short-term trade-related lending and also in Lending and Transaction Management. Outside Hong Kong, we've seen increases in, you know, India and Australia as well, so I think it's fairly diverse at the moment.

Richard O'Connor

When you look at the HKMA statistics, two-thirds of growth is in Hong Kong and one-third is outside and they're quite similar in terms of growth rates. When you look at the sectors, it's trade, for us it's mortgages growing very strongly as well in Hong Kong, so it is across the board.

Tom Rayner

Are you in line with that HKMA split?

Richard O'Connor

Yes.

Iain Mackay

Yes, we're not out of line with it really.

Stephen Andrews, Deutsche Bank

Just a follow-up second question on HBAP. I know all the focus is on capital coming out of the US, but you're actually stripping more out of Asia at the moment. Was I right in seeing there was a much, much bigger dividend paid out of HBAP this year rather than previous years? I guess the question is, you know, the idea was to pivot towards Asia and move more capital into the region and it looks like, over the last 12 months, you've actually taken more capital out, so the pay-out ratio's gone up. So should we view that as just a one-off shift? Is this just a streamlining of the balance sheet at HBAP and moving capital up to the Group? What was the thinking behind the bigger HBAP dividend rather than using the capital in Asia?

Iain Mackay

So, again, Eva will confirm. I think the dividend's remained pretty consistent out of HBAP as a proportion of earnings attributable to the shareholder, which happens to be Holdings. But, you know, we've talked about this before. This is about getting surpluses from subsidiary balance sheets into the parent company to improve flexibility and optionality around how we deploy that capital across the Group, and HBAP is no different to any other subsidiary. Every single subsidiary in the world meets its regulatory capital requirements and then, over and above that, we've set a parameter for our subsidiaries to pay out between 50% and 75% of earnings attributable to the holding company. And HBAP sits right in the middle of that range in terms of payout ratio, and the payout ratio has remained pretty consistent for the last few years. But we absolutely, with every subsidiary, are saying, 'If you do not need the capital right now, return it. If you need it again in the future, we'll give it back to you – but we want the surpluses to be sitting, liquid at the centre.'

Richard O'Connor

You saw a high dividend year-on-year but that's just BAU. And Hong Kong and Shanghai Banking Corporation was able to fund 14% year-on-year loan growth and 19% in Hong Kong, so it's not like we're starving the business.

Iain Mackay

No, far from it. Exactly right, Richard. There is no subsidiary out there that – if they can demonstrate the propensity to put profitable business on the balance sheet, they get the capital from the Group to do so.

Manus Costello, Autonomous Research

Hello, can I follow up on costs, please? Did you say earlier on, Iain, that you thought 2018 would be flat on 2017 in terms of cost?

Iain Mackay

No, I didn't. I said our goal is to try and maintain a cost profile consistent with what we're achieving, but to use positive jaws, provided we generate positive jaws and a strong positive jaws, to use some of the leverage opportunity there to make sure we continue to invest in the growth of the business. So, let's say we generate 3-4% positive jaws and we can use a percentage point or a percentage and a half or two to ensure that we are expanding the investment capacity within the operating-expense base – then we would do that.

But our goal is to keep a reasonably streamlined profile on costs, fund inflation, continue to pay at capacity through driving cost productivity through the base to develop investment, but in an organisation like this, the asks for investment outstrip the capacity within the operating-expense base to a significant degree, and it becomes a discussion around prioritisation. So, we have set an envelope. We will live

within that envelope. The extent to which we extend that envelope will be informed by how well the business performs around positive jaws, as one dimension.

Manus Costello

A couple of percent positive jaws is what you're looking for and happy with next year, then.

Iain Mackay

I'll take a basis point of positive jaws. We've got to demonstrate we can keep the cost base inside the propensity to grow revenues.

Manus Costello

Operationally, then, are you changing the way you're asking the divisions to manage their costs in any way? Have you previously given them, 'You've got to hit this cost number because we've told the market we'll have an exit run rate of $7.1 billion, so you have to hit this'? Whereas coming into 2018, 'You've got to show me positive jaws'? Is there an internal change?

Iain Mackay

No, the direction to the businesses for the last three years has been, 'You've got to show positive jaws.' They have pretty broad discretion in how they do that, but we have four global businesses. We have Andy Maguire and the Operations and Technology team. And Andy and I keep a very tight rein on how that money is being spent.

So, if you're going to deploy technology, are you doing it in a strategically consistent way across our platforms? Same if you go to the financial-crime space. Are we doing it consistently across the space? What we are working very hard on avoiding is letting everybody go off and go in their own direction. Make the case, but when it comes to who decides how to build server farms, which technologies to deploy, basically you've got to get it through Andy and the team that it's going to maintain consistency and that it's strategically aligned with what we're trying to do from a technology and process perspective.

But if John Flint or Noel Quinn, for example, come in with a project that they want to get funded (a) we look at it from an economic perspective, 'Does it work?' and then we look at it from the perspective of, 'Well, how are you going to execute this?' If it's a technology platform, 'How are you going to deploy the technology? Does the technology exist? Is it new? If it's new, do we build it or do we buy it?' And we're now, in the vast majority of cases, buying.

What we build now is basically maintenance of core systems, so evergreening of core banking systems. But when you go beyond core banking systems, it's a buy and implement. It's shorter cycle times; you can hold the supplier's feet to the fire for delivering. Does it do what it says on the box when you kind of dig it out and plug it in? So, it's about maintaining consistency in technology platforms, processes and getting more in terms of economies of scale out of this business.

Stuart made the point years ago: we never got economies of scale. In fact, we had dis-economies of scale. It's how do you maintain consistency across technology and operational processes, risk-management processes, finance processes, HR processes – and just improve that consistency. So, there is… The businesses can have a lot of discretion about what they do. How they do it – there's a lot of scrutiny and control over how it's being done. But the target for our businesses is positive jaws.

Manus Costello

Thank you.

Martin Leitgeb, Goldman Sachs

Two questions, please. One is a follow-up on the $20 billion risk-weighted assets efficiency still to come – could you comment on where that would sit within the structure? Would that come from Holdings, where you have some recent improvements, or would that sit anywhere else?

Iain Mackay

No, it's Global Banking and Markets Europe, basically. It's waiting for approval from the PRA.

Martin Leitgeb

And the second question is just a broader question on regulatory clarity. So, in terms of the structural reform still being implemented as we speak, both ring-fencing in the UK and the potential European Union IHC going forward, how much clarity do you have at this stage on what you need to deliver on those entities going forward in terms of whether it's capital funding and so forth? Do you have good visibility on what you need or is there some risk still within the structure?

Iain Mackay

No, the biggest area where there's lack of clarity is Basel IV, but around structural reform in the UK I think we're absolutely clear on what we need to do. That project is being run extremely well. We're very much on track to deliver our ring-fenced bank. We'll open up the new facility and headquarters in Birmingham in the first quarter. It could run from – well, it is running today. Truth of the matter is the ring-fenced bank is running, but it will run in its new legal structure and officially open its doors, as it were, on 1 July next year, well ahead of the game. It's an incredibly complex project, but the team have implemented well inside the cost-target range, which is good – touch wood, it'll keep going.

From a capital perspective, the common equity tier 1 that we expect the ring-fenced bank – and the non-ring-fenced bank, for that matter, although there's not absolutely clear guidance on this – is it's probably going to be 12.5-13% common equity tier 1. The UK bank is sitting at just under 11% just now. They've got a capital plan that enables them to build most of that, but we will give them some capital from Holdings to get them to the 12.5-13%. But it's a billion and a half to two that it will take to do that, depending a little bit on how they build capital – but they've got a good capital plan and they're hitting their marks. So, reasonably happy they'll get to the right place.

And beyond that it's just how the regulators may choose to respond to any pro-cyclicality or volatility that emanates from IFRS 9. It won't be revealed on transition, because you've set your book up to comply with IFRS 9 on 31 December/1 January, everybody will presumably see what that transition adjustment is, although they've got this idea that they amortise it over five years. I'm not entirely sure what that accomplishes.

But the interesting part then is, as you work through, month by month, quarter by quarter, as events occur, if you see broad-based credit cycle reversing, that will create a significant step-up in potential volatility over succeeding quarters in the impact on the P&L from IFRS 9. So, I think there is not at this point a regulatory response to how they deal with that pro-cyclicality.

James Invine, Société Générale

Iain, you were just saying that the investment proposals that you get far exceed your capacity to invest. I was just wondering how many requests you get. I mean, if you found a spare couple of billion, could you spend all of that? What sort of the rates of return are on the projects that you're knocking back?

Iain Mackay

Well, they're getting knocked back for a couple of reasons. One, they're not well enough developed, in terms of demonstrating a depth of confidence around understanding of the market and the ability to execute it. Or getting knocked back because the returns equation doesn't work, so you're asking for capital and you're not going to generate a return that exceeds the cost of our capital. Or they get knocked back because it doesn't stack up with the priorities.

Good idea, like it, good returns. We've got to prioritise. We're not going to throw money at everything, because notwithstanding we've got the capacity to do it, we've committed to delivering positive jaws. And if the business can't generate the revenues to accommodate positive jaws, then the teams need to be able to demonstrate the machinery is working really well and they're utilised all your capital efficiently before we'll give them more.

James Invine

You're sitting with a big surplus. You're kind of suggesting you've got opportunities that could be interesting but you're not doing them just to hit a Group target. Is that fair?

Iain Mackay

Well, would you rather we didn't hit Group targets?

James Invine

I guess it's a balancing act, isn't it? If you've got some really interesting projects…

Iain Mackay

To be clear: really interesting projects that stack up financially and against the priorities of the Group from the strategy perspective – we fund them. But there are some where we go, 'That's great, guys, but you've got a human capacity thing.' How much change can you take on? Think about what we're doing. We're working through DPA, in which we've invested on average a billion in the last years; we've got mass regulatory change and reporting that the Risk and Finance teams have to support, which is supported by the business, because we put them under pressure for that data as well.

We've done huge reorganisation of this Group over the last six years. There's only so much human capacity that you can take, because it's not like you can walk out on the street and grab somebody and say, 'Right, do this.' You need the subject-matter expertise to do these projects. It's about keeping tightness and discipline around what we invest our money in.

We see scores of projects and we knock back those that don't make sense against the priorities, the returns, our confidence and our ability to execute.

Richard O'Connor

And projects within the positive jaws – like the $300 million – you get a very quick payback on those. So, it's also a quick payback, so you do see the benefits in revenue and costs in, you know, year one, year two.

Iain Mackay

Claire, you've been waiting for a while, sorry.

Claire Kane, Credit Suisse

Two questions, really, just on clarification. Firstly, on the Asia/Hong Kong loan growth, I was a bit surprised about how short term it is, because I think in the slides you talk about strong term lending in Asia and then sustainable growth in the commercial bank. So, I guess, firstly, what is term lending in your internal view? Really, do you expect any of that short-term to reverse next quarter, or was it really bringing forward refinancing? That's the first question.

Iain Mackay

The book has got a mix, but on the average it goes towards the shorter, which sits between one and three years. When you start moving out beyond three years, there's not a huge amount on our book. We've got assets with customers that go from 5 out to 25 years, but it's a very, very small proportion of the book that goes beyond three years.

Richard O'Connor

You saw in GB&M in Q2, particularly in June, a spike up. You may see some refinancing back in the second half of the year as well.

Claire Kane

And then my second question is on NIM sensitivity, in particular Asia. I think we've talked a bit before about the sensitivity to HIBOR and I think – please correct me if I'm wrong – a lot of Balance Sheet Management surplus liquidity is not really in HIBOR-linked securities and that's actually got a negative relationship with rising rates. So, should we then expect that it really is just a management of the spread between the loan and deposits within the book, and it takes much longer really for that to come through, as we get HIBOR ticking up into refinancing?

Iain Mackay

In terms of how it re-prices through the asset base, yes, it takes a long time to come through. But it'll only come through if you get better alignment between, frankly, US dollar LIBOR and HIBOR. So, any capacity for this to re-price at the moment is extremely limited, but when that propensity exists it will be fairly gradual.

Claire Kane

And it's not really mechanical: it is internal refinancing and re-pricing.

Iain Mackay

I mean, what Balance Sheet Management does is manage the internal dynamics of our surplus deposits, basically, surplus funding and maturity mismatch. I mean, that's what they're doing. They're doing basic corporate treasury work on an allocation by allocation basis.

For re-pricing the business, those are the Retail Banking, Commercial Banking, Global Banking and Markets teams that work that. And it is based on a review of portfolios and client-by-client discussions, so it is not simply mechanistic. It's not that you flip a switch and this happens. It's not that HKMA comes out and resets HIBOR. That would have a clearly positive effect on our deposit base and a positive effect quite quickly. How that would flush through from the asset perspective… There's a whole set of other dynamics in terms of market liquidity, competitiveness. So, that takes longer to work though the book.

Katherine Lei, JP Morgan

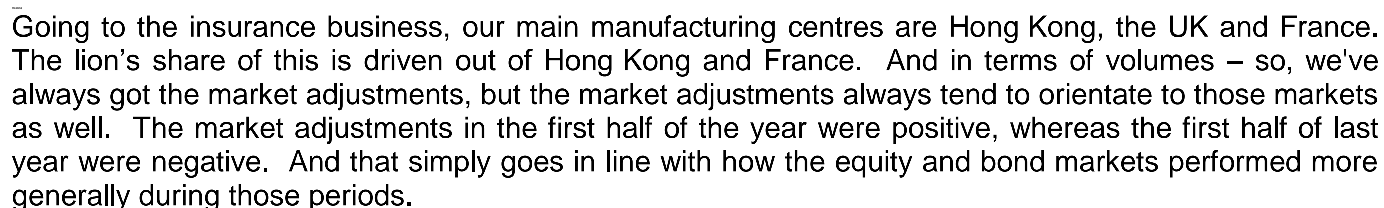
I have two questions. The first question is on page 8 of the presentation I think you mentioned that on a sequential basis insurance manufacturing is down in the second quarter versus first quarter. I wonder, was it mainly in the Hong Kong area? And what's the outlook like for the second half of the year?

Then my second question is on the Qianhai Securities joint venture. How much capital do you plan to deploy there? And, also, what would you focus on in this venture? Would you focus on the retail brokerage business or the institutional business in China?

Iain Mackay

Okay, on Qianhai Securities, first of all, this is a national licence. This is largely institutional in focus, but there is clearly an option to cater to retail as well. But, again, I would go back to the core of what we do in terms of our Chinese business. It is very much about corporate business, so it is about supporting and developing international market access to China through that brokerage. And, as a brokerage, the capital invested required – this is not a capital-intensive business, right? Look at this anywhere in the world, it's not a capital-intensive business. So, the capital is not a particular consideration here. We are stating from zero and building from there.

Strategically, for the long-term, in terms of participating in the liberalisation, modernisation and expansion of the Chinese capital market is an absolutely massive opportunity. But in terms of this representing a significant portion of our revenues, it will be a fairly slow and gradual build, starting either from late in the fourth quarter of this year or early next year, when we actually have all the licences in place and start working on it from there.



Going to the insurance business, our main manufacturing centres are Hong Kong, the UK and France. The lion's share of this is driven out of Hong Kong and France. And in terms of volumes – so, we've always got the market adjustments, but the market adjustments always tend to orientate to those markets as well. The market adjustments in the first half of the year were positive, whereas the first half of last year were negative. And that simply goes in line with how the equity and bond markets performed more generally during those periods.

In terms of new-business volumes, it was more strongly noted within the Hong Kong marketplace and Asia. That is the key driver of business performance within the insurance business in the first half of the year.

Richard O'Connor

In terms of the JV, there will be a Q3 amount which will go through costs, so you'll see that in the cost line in Q3.

Yafei Tian, Citi

I have two questions. The first is around the dividend guidance that you have a plan to maintain at 51 cents in the foreseeable future, and this is very different to the historical policy of growing the dividend. And can you explain what made you change the way you think about dividends going forward?

Iain Mackay

Long-term view of growth and profitability. We're not interested in returning capital through the dividend, because it's not sustainable. What informs the dividend is the sustainability of profits, and we think we're seeing over the next couple of years a level of profitability where 51 cents per share is an appropriate dividend to pay in terms of the yield versus the profit attributable to our shareholders. That's it. So, it's about sustaining current levels of dividends until we see, frankly, a trajectory that allows improving profitability within the group that informs the propensity to pay higher dividends. That's it.

Yafei Tian, Citi

The second one is a bigger picture question. When I look at the business over the past few quarters, there's a lot of stability that's coming back when it comes to profitability. As well as when you look at the one-off items, a lot of the one-offs are kind of falling away. There aren't big restructuring charges and CTA is also going to fall off. And you also have a new Chairman.

Iain Mackay

Not yet we don't.

Yafei Tian, Citi

And when you look at this together and think about… When you look at the business, it's pretty much on a very smooth path going forward. If the macro risk is getting better. I mean, HSBC looks a very wealthy business.

Iain Mackay

So, what's the question?

Yafei Tian, Citi

So, the question is, like, what would you do differently with the new management, new Chairman, when you look at this business of today?

Iain Mackay

I think I'll leave that to the new Chairman and the new management. There is a much better tightness and discipline within the organisation compared to five years ago. We have spent an inordinate amount of time and money putting the organisation in a much better place with respect to its ability to control

what it does across a wide range of engagement with stakeholders, whether it's customers, regulators or our investors. So, there is a strong focus on continuing to build that discipline and continuing to improve the propensity to run the organisation efficiently. And we have done a massive reshaping of this organisation over the last six years.

The new Chairman and the new CEO will pick up something that has got a greater propensity to serve its customers, which does so more efficiently, which has a robust capital position and a very well positioned balance sheet. But HSBC has been a commercial bank for 152 years, and I would tend to suggest that it will be a commercial bank for the future.

But it will be about, I think, what we've improved, continuing to improve it and continuing to make it better. And there are clearly opportunities across our portfolios. Whether it's on the revenue line, whether it's on the cost line, whether it's in customer satisfaction, whether it's building and retaining the best teams we've got around the world and whether it's providing better returns to the shareholders, there are still plenty of opportunities for a new management team to sink its teeth into, but it's up to the new Chairman and the new CEO to sit down in front of you at some point, hopefully next year, and talk about that.

David Lock, Deutsche Bank

I've got a couple, please. The first one's on regulatory costs. I think in the past you sort of talked about those running a little bit higher than you'd hoped a couple of quarters ago, but as we look into next year and, obviously, a lot of work that must have been done on setting up IFRS 9, all the changing reporting and finance things. You've got the monitor ending as well. I wonder if there are any tailwinds you could actually point to for the first time around regulatory costs for next year.

And I have a second question on Brexit.

Iain Mackay

Yeah, you know, it's a bit like 'whack-a-mole', right? When you get one set of costs seeming to disappear, something else crops up. On this occasion, it's Brexit. So, with respect to the monitor and the DPA, we obviously have been very focused for a number of years and remain very focused on fulfilling the obligations under the DPA. We've made very, very good progress in that regard. We've made great progress informing a much better capability to manage the risks of financial crime across the system and how we engage with it. The final decision as to whether or not the charges from the DPA are lifted is with the Department of Justice.

So, as you could reasonably imagine, Stuart Gulliver, Stuart Levey and Colin Bell, our Head of Financial Crime Risk, spend a lot of time trying to illuminate and demonstrate what we've done and why that's sustainable for each of our stakeholders: so, the FCA in the UK, the Federal Reserve and the Department of Justice in the US. But the final decision on those charges being lifted is with the Department of Justice. And I think it's reasonable to assume there are more factors than just us being satisfied that we've fulfilled all our obligations to that decision being made.

The five-year monitorship – that will not end until July 2018, because he didn't start until July 2013. So, he is with us through the first half of next year no matter what. But, again, if the DPA were to be extended, then one could reasonably assume that the monitorship could be extended. It is the monitorship that costs us money, incrementally. We've obviously invested significantly in our financial crime risk management capability. That's built in to the operating run rate of the Company. That runs at around $800-900 million. The monitor costs run to between $125 million and $150 million a year.

So, the opportunity if the monitor were to conclude his activities in July of next year is significant, but it's not huge. And sadly we'll be in full flow of implementing what we need to do from a contingency-planning perspective for Brexit next year. Well, we're in full flow this year, but I think the lion's share of that expenditure of that will fall into 2018.

I think Stuart Levey and his colleagues in the Legal team are doing a fantastic job at working us through legacy litigation and managing that inventory of litigation. We've had some good successes recently, but it is just part of life now. The inventory of litigation in any large corporation is significant, but the team is

doing a good job working through it. I think where we clearly see – and we talked about this two and a half years ago. We see the investment in the costs around implementing Global Standards peaking in 2017, which we do. And the trajectory of costs invested around regulatory spend – we would expect to see some improvements in that.

The reason I say 'expect' is that every time we think we're getting pretty good at what we do, the regulators come up with something else. I mean, the latest example is the PRA. They came up with this biannual exploratory scenario. And it's actually a really interesting exercise, if it had been grounded on, strategically, how would banks adapt their business models in a seven-year, long-dated low-interest-rate, low-growth, high-inflation environment and it wasn't all about filling out templates, but a large part of the exercise was about providing hundreds of thousands of data elements.

Now, the good thing I think, again, is I think we did a good job in that regard, but this doesn't happen by waking up in the morning and switching on the lights. It takes a lot of people who are very good at what they do to sit down and analyse and work with regulators, work with business teams, to build those scenarios out. So, I would love to say we've kind of reached that inflection point on regulatory demands and requests for information, but there's absolutely no sign of that slowing down in the UK at all.

David Lock

And I have a follow-on, which is about Brexit and really what you're currently thinking, particularly about the Global Banking and Markets business. I think you've obviously got HSBC France. It strikes me you could probably shift a lot of the balance sheet into France quite easily, because it will mature relatively quickly. I just wondered whether there's anything we should be thinking about from a capital perspective as you do that. You talk about $20 billion of RWAs currently awaiting model approval from the PRA. How easy is it to just move those into an SREP process monitored by the ECB? Does that trigger a whole delay around risk-weight model approvals? I'm just trying to understand how easy it is to do, particularly given the different directions of regulators.

Iain Mackay

So are we. In theory, this is pretty straightforward. We have universal banking capacity and licences that support that in France. The product offering across the French Global Banking and Markets platform, for example, or the CMB one is highly similar, with the underpinning technology being essentially the same. But it's a question about building capacity both from a human-resource standpoint and facilities standpoint and then being able to transition customers.

So, the theory of the case is you'd lift it out of one balance sheet, put it into the next as facilities mature, as you write new business with customers. But, as you can imagine, you can't just whisk the capital out and drop it in, because you're going to have regulatory transition at the same time. So, you could absolutely imagine a scenario over the next couple of years where we need to ensure the French business has got the appropriate capital to absorb the new business and support the new business, whereas you could still see some of that capital sitting in the UK and it potentially being overcapitalised. You know, operational risk would be a great example of that one on the basis of how operational risk capital is calculated.

But over time – and to your point, David, a relatively short period of time – you'd be able to transition it, where the UK becomes smaller and France becomes bigger, both in physical, capital and profitability terms.

David Lock

Just from a practical perspective, is it the case that you've got contracts written out under the London branch that you need to totally re-write under a French branch? Is it just effectively –

Iain Mackay

It's not a branch; it's a subsidiary.

David Lock

A subsidiary, sorry. Is it effectively waiting for those contracts to roll or…? I mean, how do you practically do those?

Iain Mackay

You could approach customers and novate. You could wait until facilities conclude and then roll. And those customers who couldn't be legally served from the UK would clearly appreciate that. We have some customers – not many at the moment, but we've got some customers who are saying, 'Why don't you just put my business in France?' which we're happy to do.

So, this is going to be 'Heinz 57'. There are going to be lots of different ways in which this transition is going to be managed. And part of it is going to be informed by how the customer wants that to be accomplished, and part of it's going to be what the regulation allows.

David Lock

And presumably the overcapitalisation that you're talking about in the near term, potentially, for France and the UK, as that process happens – that's being factored into your view as to why you're operating with such a high core tier 1 ratio and the buy-backs and… It's one of many things.

Iain Mackay

It's one of those balls we've got to keep in the air, yes.

James Chappell, Berenberg

Two questions about costs, the first is really: having gone through this programme, how much flexibility do you think you've got in the cost base now, particularly if revenues disappoint and you're trying to deliver positive jaws?

I suppose my second question, which partly relates to that, was your comment earlier that, previously, you had dis-economies of scale in the business. Why do you believe that's changed or how have you changed that, over the last few years?

Iain Mackay

We've taken $6 billion out, looking at how we make decisions about how we deploy technology, how we deploy new products, the number of platforms on which we serve products, for example: the number of platforms that we support credit cards around the world has been reduced by about 80-90%; the amount of headcount sitting in data centres that are dealing with higher volumes than was the case three years ago, but with a smaller headcount. An example that my finance colleagues feel very personally, and I appreciate, is that our cost base in finance is down more than 25% and the finance teams are doing more than they've ever done. Part of that is because they're working bloody hard and part of it is because we're better at what we're doing now. You've seen it similarly in risk. There's just much tighter control around contracting, but there's still huge opportunity.

There was an interesting example; we're putting a new payables platform in, which we're starting in the UK, which is proving to be interesting. One of the things that's proving to be interesting is we're learning a good deal more than we've ever known about our UK supplier base. We have bloody thousands of suppliers in the UK for just the goofiest things. Simple consolidation around that supplier base and leveraging purchasing power gives the procurement teams – who have done a great job, not just over the last three years but over the last five or six years – capacity to do more.

That flexibility in the cost base isn't a God-given right. You've got to work at it every single day. I don't think there's ever a day you walk in and go, 'Right, well if revenues went down by 20% tomorrow, we'd know exactly what to take out and exactly what to cover.' It would be really hard work to do, but what is clearly demonstrated by our teams is they now have the capacity and understanding of, one, the imperative of doing it and, two, how to do it. This game never stops. It's the same as going after

customer business; you've got to do it every day and it's the same on costs. You never reach a point of optimal performance on this basis, in my view.

James Chappell

And if revenues weren't to grow to jaws?

Iain Mackay

Flat to down.

Alastair Ryan

Sorry, second question. It might have just misunderstood this, but your ring-fenced bank in the UK, if you need 12.5-13, that's quite a lot higher than some of the other banks have suggested they'll need. Is there any reason that you'll need or is that just your maths?

Iain Mackay

No, you've just given me a piece of information. I'm going to go back and have a chat with my regulators, Alastair. I think it's the same across the piece, I really do. This is a silly little story, but myself and a couple of colleagues were sitting across the table from our supervisor.

Alastair Ryan

It is just one of your peers in particular,

Iain Mackay

Really? It depends how small they are. We were going through ICG for the ring-fenced bank and they said, 'Well, we need to put a concentration risk charge on that.' 'Really?' HBEU today, in the UK, doesn't have a concentration risk weighting on it in Pillar 2A. It's got Global Banking and Markets; it's a credible, well-diversified business, by industry sector it serves, by the parts of the UK it serves, by the product lines, across the credit portfolios, across trade risk. We ring-fence it and we're going to have a concentration risk. Logically, you absolutely follow it, but I just find the whole thing slightly ironic, but anyway. Is that really what John Vickers thought he was going to accomplish? Who knows? Sorry, was that the whole question? If you've got somebody out there than has a lot less, pass the name on because I'm going to have a chat with the regulators.

Gary Lam, Citi

Two questions if I may, firstly on margin. Your Hongkong and Shanghai Banking Corp margin is actually up 10 basis points in the first half versus full-year last year. It seems that the first-half margin is down for the Group. It's driven by elsewhere. Going forward, where do you see, barring any high expectation of rate hike, is the pressure still here or are you seeing it turn around in the second half?

Second question: thank you for disclosing the China exposure on page 37 of the appendix. You illustrate you have 0.2% of corporate lending market share in China. The] market expectation of you in China seems to be volatile a lot. One or two years, we may have a consensual view that RMB will quite significantly depreciate. The market right now is forming a slightly different expectation, maybe stabilising. Do you share this volatility in the market perception and, on all these volatility tests, what would be the key indicator or watch point to move the needle of your China risk appetite? Thank you.

Iain Mackay

The last one first, we maintain a very consistent risk appetite around mainland China, by virtue of the fact that we are a very small part of the market. We are very selective about the business that we do. With that fairly tight focus, there is lots of business for us to chase within that risk appetite and grow. That's what we've done for the last 10 years in China and that's what we fully expect to be able to do, with that risk appetite, for the foreseeable future. Is there volatility? There's volatility in China, just as there is in every other market that we operate in. We have large exposures. We're acutely aware of the importance of managing the Chinese book and Chinese-related exposures – because, as you say, a lot

of those exposures are outside China – and managing that exposure well, from a risk management perspective. It is the focus on a day-to-day basis, but we continue to look at the Chinese market is being one of the best growth opportunities for the Group. We are positioned to be able to pursue that growth.

From a margin perspective, what we saw coming though in Hong Kong was continued pressure on asset margins, but significant improvement in liability margins, principally with rate adjustment coming through the deposit base and lower cost of funds. That is basically what's driving it and it is largely informed if you broke down everything in net interest margin over the first half of the year or the second quarter, for that matter. It's continued pressure coming through the US on the final run-down of the sub-prime legacy portfolios. It's a little bit of margin pressure coming through the UK on the asset side. It's a little bit of asset margin coming through Hong Kong on the asset side and, broadly speaking, that being offset by improved liability margins across the US dollar deposit base.

Richard O'Connor, Head of Global Investor Relations

There are obviously TLAC costs, hopefully in the holding company, not so much the Asia-Pacific sub.

Ewan Chen, IB International

Just a quick question on IFRS 9 I just want to clarify: in Hong Kong's case, we have HKMA proposed that Hong Kong banks may use the regulatory reserve to offset any potential increase in expected credit loss. For the other parts of HSBC, based on your current estimation on the expected credit loss, do you think that the other parts of HSBC are likely to see a potential rise in credit costs? How should we perceive that?

Iain Mackay

IFRS 9 is about timing of recognition of credit losses. One of the most important things for us and the industry to do is keep our discipline around underwriting standards in our commercial behaviour, with respect to the provision of credit to our customers. What it will do is it will change the timing and potentially create spikes and volatility within the recognition of loan impairment allowances, as we have credit moved through from stage one to stage two, from a loss recognition perspective.

The UK regulator, as far as I know, has not given any indication that we would use Pillar 2A buffers to offset IFRS. What they have said is that they would use Pillar 2A buffers to offset the impact of revisions coming through Basel IV, but they've not given an indication – as far as I know, Gavin – on Pillar 2A buffers for IFRS 9. I was not aware that that was the case in Hong Kong either. Eva, I don't know if you can provide any illumination as to whether we heard anything definitive from the HKMA in that regard?

Eva Law

The latest is that, on the deductions side, so it will come through regulatory reserve adjustment, which you are alluding to. That is the latest from the HKMA front.

Gavin Francis, Group Chief Accounting Officer

The reality is that every national regulator, in a European context obviously the EBA, is at a different point in terms of determining what, if any, day-one transition requirements are going to be in place. Yes, you've got some clarity in Hong Kong at this point in time. We don't have that clarity across Europe, including the UK, so that's item number one.

Item number two is the other thing that Iain's referred to as well. Once you pass day one, then the question is, as you get pro-cyclicality through the IFRS accounting number, how does that feed through to regulatory capital and what changes, if any, in the regulatory capital framework might be put in place to basically mitigate or otherwise manage that. That second part of the debate is arguably more important than the first part of the debate about day-one impact. That second part of the debate really is only just starting within the regulatory community.

Stephen Andrews, Deutsche Bank

Can I just have a follow-up on the $300 million incremental investment that's coming in the second half? I think you said it's reinvesting the Visa gains in the US and North American retail businesses. I'm just curious; that's quite a large number relative to the size of the cost base within those businesses. I think businesses have struggled, so I thought it was largely due to a business mix issue and that we don't want to do the high-risk home equity loans and stuff like that in the US. What have you identified as the problem from a profitability perspective, in that US retail bank, which requires $300 million of investment remedy? Is it, 'Okay, we're going to move into different business lines, because we're not getting the returns up unless we look more like a normal US retail bank'? Or is it just technology's not up to scratch? It's a big number; where does it go?

Iain Mackay

In actual fact, the lion's share is going into Canada and it's about market expansion and rebuilding share that we've lost in Canada. It is largely technology and product development orientation, so it is bringing the mobile applications, the background technology to support that and rebuilding, frankly, market presence on the east of Canada, as well as in British Columbia. There is a small portion of it going into the US, which is mostly around systems and technology improvement on the mobile platform and then in Canada it is much more fundamental, around distribution capability, as well as digitisation of the channel.

Richard O'Connor

And not just RBWM, but CMB and GB&M as well, in Canada.

Iain Mackay

Yes, there's a little bit in CMB. Of the $300 million, more than two thirds of it's going into Canada.

Adam Lee, UBS

Just a quick one on the scrip dividend: I think, since 2014, cumulatively it's about $4 billion that's come through as either capital raising or dilution level, however you want to look at it. I was wondering how you guys think about that now it, certainly in the last quarter or last half, has equalled the buyback amount almost. How do you guys think about that component, whether or not we're going to see that, going forward?

Iain Mackay

Look, in periods of stress, having had the scrip has been actually a quite nice thing to have. When you're moving along quite nicely, it's a bit of a nuisance from a dilution perspective. It's a topic that comes up and is the subject of a lot of work internally, in terms of how we could replace the scrip with, for example, a dividend reinvestment programme. The problem, partly, is that the scrip seems to be most popular in Hong Kong, where it is not just our retail investors, but it's a large proportion of our customers, both corporate and retail, which take up the scrip on a regular basis. Dividend reinvestment programmes basically don't work in Hong Kong. There isn't a policy framework to support it from the SFC.

Ideally, we would like to substitute the scrip for something else, but not necessarily remove that facility altogether. It's just an area of continued focus. If you went back seven or eight years when we got a big take-up on the scrip, everybody had a big smile on their face. When we get a big take-up on the scrip now, everybody's a bit fed up with the whole thing, because it's a dilution effect that we need to try to offset. It gets constant attention, but there isn't an easy flip-the-switch solution to the scrip right now.

Tom Rayner

I started on costs; I'm going to finish on costs. I hear what you're saying on the positive jaws and I get the message. I'm just wondering though, and this is partly dependent obviously on where you finish up 2017, when I think about next year, you've got some one-off investment falling out. You've got some full annualisation of cost savings already achieved, but not yet in the 2017 figures coming through, and you should hopefully be finding some other gross savings, which might go towards offsetting some of the underlying pressure. Holding costs flat, shouldn't that really be your minimum objective? It actually may

be shrinking the costs on a constant-currency basis in 2018 might be something that is a realistic thing to look at.

Iain Mackay

I think it comes back to this question earlier. You don't want to starve the business of investment when you've got an opportunity to grow the business. We've provided, I think, reasonable guidance around the exit run rate and that exit run rate incorporates the savings that we've earned, but not booked, in 2017 moving into 2018. That run rate, that exit run rate for the fourth quarter, provides you with a reasonable basis on which to estimate. To achieve that, we've got to offset inflation. We will have $600 million, give or take, coming through the cost base in 2018 in inflation, so we need to find $600 million of economies to offset that, just to start with.

The second objective is talking in response to Manus's question: continue to create capacity to invest and grow the business. The capital is one thing. We've got it; we've got all the capital we need. Within the operating expense base, you need to create the capacity within that to expend the capital without blowing the financial dimension on the P&L out the door. We've got to find $600 million more. Day one, we all start 2018 going, 'We've got to find $600 million more.' Yes, we're a big organisation, but $600 million doesn't fall off the trees. The focus is to deliver cost productivity, maintain a reasonably flat profile and, where we see opportunity coming through to grow the business, providing we're hitting positive jaws, provide the capacity to do that through using some part of that positive jaws – but positive jaws.

Richard O'Connor

Thanks, everyone.

Iain Mackay

Thanks, everybody.

Forward-looking statements
This presentation and subsequent discussion may contain certain forward looking statements with respect to the financial condition, results of operations and business of the Group. These forward-looking statements represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Additional detailed information concerning important factors that could cause actual results to differ materially is available in the HSBC Holdings plc Annual Report and Accounts 2017. Past performance cannot be relied on as a guide to future performance.