HSBC

Transcript

Fixed Income Call
Q2 2020 Results

3 August 2020, 2 pm BST

EWEN STEVENSON, GROUP CHIEF FINANCIAL OFFICER: Good morning or good afternoon all. It's Ewen here, the Group CFO. I'm joined today by Iain MacKinnon, our Group Treasurer, who's actually joining by phone from a different location, and Greg Case, our Head of Fixed Income Investor Relations.

There's a Fixed Income-specific slide deck available on our website, but we don't plan to speak to specific slides as part of these introductory comments. We'll keep the introductory comments brief, and I know you'll all have had a chance or will have a chance to listen to the Equity call that Noel Quinn and I did earlier today. I was planning to quickly run through what we've announced today and then hand over to Iain MacKinnon for more detail on capital and funding before opening up for any questions you have.

Firstly, a few words on the current environment: we clearly continue to be in a very unpredictable environment, but I think we've responded well, and we continue to do what we can to support our customers through what is an exceptionally difficult period. I think, in that context, we're satisfied with how the business is performing. Asia has held up well for us, and within Global Banking and Markets, the Fixed Income business delivered very strong revenue growth in the second quarter.

Businesses that performed less well are largely in areas that we've already committed to change and we'll be accelerating our transformation in the second half. The Bank remains strong and resilient, with excellent funding and liquidity positions, and our Core Tier 1 improved to 15% in the quarter.

Turning to the second-quarter results themselves, given the impact of COVID-19, the second quarter was tough financially. We had an 82% fall in reported profit before tax and a 57% drop in adjusted profit before tax. Our results were heavily impacted by lower revenues, which came from a combination of subdued customer activity in many parts of our business and the building effect of ultra-low interest rates. It was the second quarter in a row of very high expected credit losses, and we also had a $1.2 billion software intangible write-off, largely as a result of the weak return outlook for the non-ring-fenced bank.

On revenues, adjusted revenue was down 4%, which included a $507 million benefit from volatile items, which in part reversed some of the negative impacts we saw from mark-to-market movements in the first quarter. Expected credit losses were up on the first quarter, $3.8 billion in total or 148 basis points of gross loans, with the largest impacts seen in the UK geographically and in Commercial Banking amongst our three global businesses. UK expected credit losses were $1.1 billion higher than the first quarter, reflecting the worsening economic outlook for the UK, of which $900 million related to our UK-ring-fenced bank. Stage 3 expected credit losses charges were broadly stable at around $1.5 billion in both the first and second quarters, although the first quarter included a significant charge on a single corporate exposure in Singapore.

Recognising the deterioration that we saw in the economic outlook in the second quarter, we've updated our range for the full-year Group expected credit losses to $8 billion to 13 billion. The lower end reflects a path closer to our consensus central economic scenario, reflecting a strong economic rebound in 2021 with some unwinding of the economic adjustments taken to date. The higher end of the range reflects a path closer to our downside economic scenario, with a much more muted economic recovery in 2021, leading to further negative ECL adjustments for forward economic guidance in the second half. I'd caution that there remains a wide range of potential outcomes, including the risk that the upper end of the range may need to increase further, and in that respect I would encourage you to read our ECL sensitivities in the interim report.

As we look out to the second half, there remains considerable uncertainty, whether that be from the continuing impact of COVID-19, the ongoing Brexit negotiations or the US-China tensions and any impact that has on our Hong Kong franchise. As such, it is too early to discuss distribution policy or medium-term return targets, and we don't expect to do so until our full-year 2020 results in February. However, we're pleased that we face into this uncertainty with a strengthened Core Tier 1 ratio at 15%, an extra $85 billion in customer deposits through the second quarter, continued vigour in managing our cost base down, down 7%, Q2 on Q2, and the benefit of a diversified portfolio of franchises globally.

Noel and I remain very committed to the plan we announced in February, namely a material reduction in RWAs, particularly focused on the US, the non-ring-fenced bank and Global Banking and Markets, with a reallocation of these RWAs towards our strongly performing Asian franchise; secondly, a significant reduction in the operating cost base of the Bank; and, thirdly, a material reduction in the ongoing operating complexity of the Bank.

With that, I'll pass over to Iain to run through the balance sheet.

IAIN MACKINNON, GROUP TREASURER: Thanks, Ewen. Hi, everyone; Iain here. Thanks for dialling in. Despite the weak macro environment, the balance sheet metrics continue to remain very strong and improve. Our CET1 ratio was up 40 basis points to 15% in the quarter and our fully loaded CET1 ratio was 14.9%. Customer deposits grew by $85 billion, resulting in a loan-to-deposit ratio of 66.5%. That's down 5.5 percentage points since the start of the year.

The Group remains very liquid, with gross high-quality liquid assets of over $780 billion on hand. That's up $138 billion from the end of last year. Our consolidated liquidity coverage ratio on the European delegated act basis was 148%. That's broadly flat in the half.
With regards to the 2020 issuance plan, as you'll have noted, our gross and net issuance is significantly down in 2020 versus prior years. We did expect this. We did say we would remain flat. We did successfully tender for $3.3 billion of 2021 bullet securities while issuing $3.5 billion of new five and 10-year callable paper, managing down next year's refinancing needs. But this year we continue to expect to keep our net issuance around zero in MREL senior. Our Tier 2 need will remain zero, and we don't expect to grow the balance of our AT1s.

With that, I'll hand back to Ewen.

EWEN STEVENSON: Thanks, Iain. We can now open up the lines for any questions, please.

DANIEL DAVID, AUTONOMOUS: Hi there. Thanks for the call and thanks for taking my questions. I have two. Just looking at your issuance plans, as you said, it looks like mostly refi-ing HoldCo senior and AT1. Looking ahead at the maturity profile, you've also got more maturing in 2022. On HoldCo senior, would you look to pre-finance any of that $15 billion that's rolling off alongside the nine in 2021? And, on AT1, can we assume that you'll run at the level of AT1 you've got now? And also are there any changes to Tier 1 double leverage that we should think about when considering your AT1 plans?

The second question is just on LIBOR transition. Can you give us a bit of an update on how you're progressing? Are there any products that you think might be behind the transition effort? And also how are you thinking about the DISCOs in the context of LIBOR transition? Thanks.

EWEN STEVENSON: Iain, do you want to start with that? We've got Greg here too, who can pick up.

IAIN MACKINNON: Yeah, on the '22 refinancing, yes, we are looking ahead. We will take the temperature on that as we go through the end of this year and early next year and probably look to do some refinancing, a bit like we've done now, but it very much depends on market conditions and appetite.

With regard to the AT1, I think we're not expecting to extend it, with regard to the extent of the base of our AT1. With regard to the double leverage, with the fall-back and cessation of the dividend, double leverage is running at or about risk appetite, so we're actually seeing nothing untoward there.

And then, on the final point, I'll maybe hand over to Greg. I don't feel I can really comment on the DISCOs at the moment.

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: Yeah, sure. Thanks, Iain. Greg here. So, as a general point on LIBOR, I think we're aligned with the industry on this. I think we're very keen to move towards the new standards, and we've been doing that with our more recent issuance. We're looking at what opportunities we'll have to make sure we're as compliant as we can be and want to be working with the investment community to ensure that we're getting the right outcomes in time, but obviously we've still got plenty of time to work that through.

Specifically on the DISCOs, we're not going to talk to individual bonds. We don't want to give any kind of legal analysis, but our main intention, where we can, is to try to remediate bonds and move over to the new reference rates where we can.

DANIEL DAVID: Great, thanks a lot.

PAUL FENNER-LEITAO, SOCIÉTÉ GÉNÉRALE: Hi, can you hear me?

EWEN STEVENSON: Yep.

PAUL FENNER-LEITAO: Thanks for taking my questions. I have two quick ones. First, I didn't quite – just to be completely clear, are you still aiming to issue AT1 this year to cover what you redeemed earlier, or is that now off the table for the remainder for 2020? That's question number one.

And question number two – I'm sorry if I missed it on the main call this morning. What I think is apparent is the transformation programme is fixing things that investors are, you know, have become more or less comfortable with, at least in terms of the uncertainty. And the – what people are worried about are the businesses that have typically gone okay in Asia. And so I can only put the recent, you know, HSBC underperformance in bond-land – I can only think that that's because people are worried about what's going on in China, Hong Kong. What is it that you can tell us about [inaudible] to HSBC's business?

IAIN MACKINNON: Maybe I can answer the –

GREG CASE: Sorry, we missed the question at the end there. Paul?

PAUL FENNER-LEITAO: Yeah, hello.

GREG CASE: Yeah, sorry, we just missed off the question at the very end there.

PAUL FENNER-LEITAO: Yeah, so my question – with investors, that's what they're kind of worried about. And I'm never quite sure what it is I can tell them. I know it's not in your… You know, you're not political analysts; you're not economists. But you can tell us something about where you think foreign policy in the US, in the UK, in the European Union vis-à-vis China, Hong Kong – where that could impact your business most readily so we can just start to factor in some potential downside risks.

EWEN STEVENSON: Yeah, look, I don't think we're going to sit on a call and publicly speculate about the foreign policy position of various governments around the world. I mean, all I can point to, as I said earlier on the call, is, if you look at the underlying financial performance of – whether it's our Hong Kong business, which was continuing to attract deposit flow in Q2, the China business, in which profits were up materially in Q2, it's very hard to point to anything that's having any material impact on our business at the moment as a result of geopolitical tension, so… But we're not going to speculate on the position of various governments' foreign policy around the world.

On the first one on AT1 issuance…

GREG CASE: Yes, sure, so, Paul, no plans to refinance that call that we made in January. We're happy with where the Tier 1 capital moved to after that. So, you know, as we look out over the course of the next 12, 18 months, we've got – our next new-style AT1 call is not until next summer, so we'll obviously look at that as and when. Clearly, we've got the legacy Tier 1 capital credit starting to roll off, and obviously we'll think about how we look at that in the future and whether or not we refinance that. But, if we were to issue any AT1, it would be to refinance, rather than anything else.

PAUL FENNER LEITAO: And, sorry, that won't happen this year.

GREG CASE: We wouldn't rule it out, but at this stage there's nothing immediately planned.

PAUL FENNER LEITAO: Okay, thank you.

ROBERT SMALLEY, UBS: Hi, thanks for doing the call. Just a couple of quick questions, as you covered a lot already this morning and in the earlier call. Just in general, loan-loss provisioning – a number of your peers have said that they feel they're around peak provisioning. You seem to be indicating that you're going to have similar levels, at least in the third quarter. Could you talk about – just give us an idea around that and where you think that's going to come from?

Secondly, on liquidity, could you give us, if possible, a breakdown on…? Because I'm looking at slide 9. You've got it by division; could you give us a breakdown geographically? How much of that liquidity is in the UK, for example, and how much do you need to keep there around changing economic circumstances and Brexit?

And then, third, I just want to be clear on issuance on page 18. As a gross number, roughly how much HoldCo senior are you looking to issue for the remainder of 2020? Thanks.

EWEN STEVENSON: It's not what we said in relation to ECLs. We indicated in the first half of the year, we had just under $7 billion of ECLs, and for the second half of the year we've indicated a range of $8-13 billion for the full year, which, mathematically, implies somewhere between one and six for the second half. So I don't think we're indicating that we continue to naturally expect the third quarter to see the same run rate that we saw in the first two quarters. I think the key determinant as we go into third quarter will be, 'Is there any material shift in forward economic guidance?' And I think, unlike some of our peers – I know a couple of our UK peers last week talked about much lower sensitivity, but they would caveat it with no change in forward economic guidance. That's not what we've said. We've acknowledged the fact that there could be changes in forward economic guidance, and hence why we've come out with a broader range.

GREG CASE: Rob, so on the LCR we've given the ratios on the slide, but there's more detail in the interim report, so you can see the HQLA by entity on page 82 of the Interim Report that we put out this morning, so that should give you more insight.

On the issuance plan in terms of gross HoldCo senior, I think when we set out the plan at the start of the year we obviously had in mind that we were looking to do the liability management that we undertook, and that's why we were very clear with our guidance that it was refinancing. So if you look at what we've got to do with the rest of the year, we've got about $3 billion, $3.5 billion of HoldCo senior that matures this year – or is callable this year, sorry. Subject to those calls being made, then we'll probably look at refinancing them, but that's not even necessarily going to be 100% the case either.

ROBERT SMALLEY: Thanks, that's very helpful. Appreciate the call.

JAKUB LICHWA, RBC: Hi there. Thanks for having the call. Just one from me, please, more on the payment holiday [inaudible]. When you think of the stock of loans which moved to stage 2 – I understand that these do not include the loans that are on payment holiday. When you think of the loans in these categories, stage 2 and payment holiday, which one do you think is riskier? Can you give us some sort of idea about what are your thoughts behind the risk of each of these? Would you expect more losses to materialise over the next – I don't know – six or 12 months? And, yeah, anything would be helpful.

EWEN STEVENSON: I guess within the payment holiday all of that – I mean, you're clearly having to make significant assumptions in terms of, likely impairments against those payment holidays when they roll off. I guess we'll learn a lot more in the next one to two quarters, as they do, but we have built in assumptions into that range of $8 to 13 billion that we came out with. You know, for example, in the UK, there are very big judgment calls, for example, on, 'Where does UK unemployment go post the end of the furlough scheme?' which then rolls through to whether that puts stress, or what degree of stress that puts, on payment holidays.

But we've set out on page 67 of the Interim Report some fairly detailed analysis of what relief we've given where, and you can make your own assumptions on that in terms of the type of loss rate you would factor in, but we have made those judgments in coming up with the $8 to 13 billion range.

JAKUB LICHWA: Okay, thank you.

LEE STREET, CITIGROUP: Hello. Good afternoon, all. Thanks for taking my questions. I've got a couple of questions on stage 2 and then one on ratings.

Just on stage 2, there's obviously been quite a significant increase in the stage 2 balances, which looks to be mostly coming from the corporate and commercial lending. So I'm just trying to understand what's driving this. Is this fundamental in terms of a real greater risk or is this HSBC being a bit more conservative in the way they're doing IFRS 9 and sort of moving things from stage 1 to stage 2, because we're not necessarily seeing a uniform movement across all banks. That's number one.

Number two – linked to that and a little bit like the last question, obviously, there's quite a big discrepancy at the moment between stage 2 balances and stage 2 balances that are actually past due, which I'm guessing is obviously coming from the payment moratoria. So just how would you recommend that we go about looking at and understanding what proportion of stage 2 balances are likely or going to actually move into stage 3? Because obviously that's the key question.

And, just finally, on Moody's, I'm presuming you have a regular interaction with them. Any thoughts or comments on the risk of a potential Moody's downgrade for you, basically? Those would be my three questions. Thank you.

EWEN STEVENSON: Well, on the last one, I don't think we're going to speculate on what Moody's may or may not do, and it's probably a question that's better directed at them.

On stage 2, it's mainly the deterioration in forward economic guidance that we've seen. If you go from end of April, when we announced Q1 results, and run through week on week through to about mid-July, what we saw is a steady deterioration in the economic outlook for the global economy – and more pronounced in some places such as the UK, almost week on week. And it only really began to stabilise in July, i.e. [inaudible] was what people thought for 2020. We did see some uplift in economic recovery in 2021, but not enough to offset the sharpness of the V or the recessionary event in 2020.

Yeah, I mean, you obviously have to run your own maths on this. I mean, it's a very complicated set of judgments that you need to make in this environment, given the models haven't seen any event like this. So, the models are probably less predictive and reliable, particularly when you get to more extreme ends of downside scenarios. We have had to take some underlays as a result that we set out. You're trying to factor in the impact of government support packages and, when those government support packages roll off, what is going to be the impact on credit. And, yeah, so all of that thinking has been factored in to the best extent we can in coming up with the $8 to 13 billion range. And we try to give you as much detail as you can to allow you to take different assumptions and apply different probabilities to our various scenarios, as set out in our interim report.

LEE STREET: Okay. Okay, I understand. And just a quick follow-up, sorry – just in terms of your stage 2s, because I guess stage 2 can also encapsulate incredibly high-quality credit that's seen a slight deterioration in probability of default as well as things that are much riskier. Is there any commentary you can give around sort of – is that the case? Is it high-quality stuff that's sort of blowing up the balances in stage 2 there or is it just a mix?

GREG CASE: Lee, well, so the Pillar 3 doc is coming out in a week or two, and you'll be able to see how CRR and other credit gradings that we use internally have migrated. So you'll be able to get a reasonable idea from that.

LEE STREET: Alright, perfect. Thanks, all, for your comments.

EWEN STEVENSON: Okay, thanks. Thanks a lot, everyone, for joining the call today. I appreciate you taking the time to join. If you have got follow-up questions, if you could follow up with Greg Case, our Head of IR, through the normal IR channels that you have. But thanks again for joining, and speak in the coming months.