Edited Transcript

Annual Results 2016

Conference call with investors and analysts

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Corporate participants:
Douglas Flint, Group Chairman
Stuart Gulliver, Group Chief Executive
Iain Mackay, Group Finance Director

HSBC

Douglas Flint, Group Chairman

Good morning from London, good afternoon in Hong Kong, and welcome to the 2016 HSBC annual results call. With me today are Stuart Gulliver, Group Chief Executive, and Iain Mackay, Group Finance Director. Before we start, I'd like to say a word on behalf of the Board.

HSBC's performance in 2016 was broadly satisfactory against a backdrop of far-reaching geopolitical and economic developments. Operating performance in the second half of the year was much stronger than expected, as businesses and financial markets responded more optimistically than predicted. The Board was happy with the traction from management actions to reshape the Group and address the challenges of the continuing low interest rate environment. These actions are bearing fruit through market share gains, greater cost efficiency and improved performance.

Much of the heavy investment in reshaping the Group to improve productivity, embrace technological change and reinforce global standards of business conduct has been made. We enter 2017 with the restructuring of the Group essentially completed, and with a strong capital position and a conservative balance sheet. We delivered on our commitment of maintaining the annual dividend in respect of the year at $0.51, as indicated at the interim stage. This was delivered through the declaration today of a fourth interim dividend of $0.21. In addition to this, the Board has determined to return to shareholders up to a further $1 billion by way of a share buy-back. I'll now hand over to Stuart to talk through the key points before Iain takes a more detailed look at our performance.

Stuart Gulliver, Group Chief Executive

Starting with slide two, we made good progress in 2016. The implementation of our strategic actions is well advanced, and our global universal business model performed well in challenging conditions. The drop in reported profit before tax reflected a number of significant items. The non-cash items included a $3.2 billion write-off of goodwill in Global Private Banking in Europe, and fair value losses on our own debt of $1.8 billion. The cash items included $3.1 billion of investment in our cost reduction programmes, $681 million related to legal settlements and provisions, and $559 million related to UK customer redress. The reported number also includes a $1.7 billion accounting loss on the sale of our Brazil business.

Our adjusted profits were broadly unchanged year-on-year following solid performances by our global businesses. These enabled us to capture market share in strategic product areas and build a platform for future growth. We delivered positive adjusted jaws in 2016. Global Banking & Markets recovered from a sector-wide slow start to the year to generate higher adjusted revenue than 2015. Commercial Banking performed well, particularly in the UK and Hong Kong, growing revenue in spite of a slow-down in global trade. Retail Banking & Wealth Management performance was mixed. Overall revenue was down compared to 2015, due largely to the impact of reduced client activity in Hong Kong on our Wealth Management businesses. However, strong mortgage growth and higher current account and savings balances helped to increase revenue in Retail Banking.

We have written off all the remaining goodwill in the European Private Banking business. This goodwill relates principally to the original purchase of Safra Republic Holdings in 1999. The restructuring of Global Private Banking is now largely complete, and although Global Private Banking is now much smaller than it was three years ago, it is deliberately positioned for sustainable growth with a focus on serving the personal wealth management needs of the leadership and owners of the Group's corporate clients. This was reflected in 2016 through solid revenue growth from Group-referred relationships.

We continue to make strong progress on our strategic actions to improve returns and gain maximum value from our international network. Our targeted reduction of risk-weighted assets is now 97% complete, and we expect to exceed our reduction target for the end of 2017. Our cost reduction programmes continue to bring down our adjusted operating expenses. The traction that these programmes have gained in the last 18 months has enabled us to increase the amount of costs that we're able to remove from the business. We now expect to deliver annualised cost savings of around $6 billion by the end of 2017, about $1 billion above our original target, and will invest an equivalent total of around $6 billion over the same timeframe to achieve this.

Improved lending and deposit balances, interest rate rises and better collaboration between businesses helped generate significantly higher profits in our Mexico business year-on-year, and significant market share gains, particularly in consumer lending. We continued to build our business in Asia-Pacific, launching our first exclusively HSBC-branded credit card in mainland China, growing assets under management and insurance new business premiums, and seeing the first signs of growth in our loan book in the Pearl River Delta. We also extended our leadership of the offshore renminbi bond market and achieved our best ranking for China outbound mergers and acquisitions since 2003.

We completed the $2.5 billion share buy-back in December that we commenced at the half-year and we are today announcing a second buy-back of up to $1 billion to retire more of the capital that previously supported the Brazil business. Having received the appropriate regulatory clearances, we aim to complete this new buy-back in the first half of 2017. This will bring the total value of shares repurchased since last August to $3.5 billion. Our strong common equity tier one ratio of 13.6% reinforces our ability to invest in the business, support the dividend, consider future share buy-backs and manage the continuing uncertain regulatory environment. Iain will talk you through the numbers.

Iain Mackay, Group Finance Director

As you may already know, we have re-segmented our results with the Global Businesses now representing our primary reporting segments, and have replaced the business line known as 'Other' with Corporate Centre to better reflect the way we manage our business. Corporate Centre comprises Central Treasury, including Balance Sheet Management, our legacy businesses, interests in associates and joint ventures, central stewardship costs that support the business and the UK bank levy. There are more details on the Corporate Centre in the appendix. Our published re-segmentation document also provides detailed analysis and reconciliation of this reporting change.

Looking quickly at some key metrics for 2016, the reported return on average ordinary shareholders' equity was 0.8%. The reported return on average tangible equity was 2.6%. On an adjusted basis we had positive jaws of 1.2%, and we had a tangible net asset value per ordinary share of $6.92. The movement in jaws was due to a 3.7% reduction in adjusted operating expenses, which exceeded a 2.5% fall in adjusted revenue in 2016. Our adjusted measure includes the impact of the bank levy. Tangible net asset value fell by $0.45 in the fourth quarter, driven largely by foreign currency exchange differences and movements in available-for-sale investments through Other Comprehensive Income. There is more detail on this movement in the appendix.

Slide four shows the impact of significant items and currency translation in the fourth quarter on our reported profits and on our return on equity. The largest significant items in Q4 were non-cash items, namely the $2.4 billion write-off of the remaining goodwill in the European Global Private Banking business, and $1.6 billion arising from changes in credit spreads on our own debt, designated at fair value. They also included $1.1 billion of investment to achieve our cost savings. Adjusted profit before tax for the fourth quarter was up 39% year-on-year. Adjusted profits for the full year were broadly stable. Our return on equity was 0.8% and our return on tangible equity was 2.6% for 2016, with both adversely impacted by significant items. Excluding these items and the bank levy, our return on equity was 7.7% and our return on tangible equity was 8.5%.

Slide five provides more detail on the items that take us from reported to adjusted for both the fourth quarter and the full year. You'll find more details of these adjustments in the appendix, and the remainder of the presentation focuses on adjusted numbers.

Slide six looks at fourth quarter profit before tax. Adjusted profit before tax was $738 million higher than the fourth quarter of 2015, driven by significantly lower loan impairment charges and continued robust cost management. The decrease in revenue is due predominantly to adverse valuation differences on long-term debt and associated swaps, caused by sharp interest rate rises in the fourth quarter. The negative impact of these valuation differences was $742 million compared to a negative impact of $126 million in the same period last year. The full-year negative impact of this difference was $278 million. We do not forecast this for revenue purposes, as we've hedged these bonds over their duration, and the short-term valuation differences are not meaningful. There are more details on this in the appendix. Against this, there were strong performances in Global Banking & Markets and Commercial Banking.

Slide seven looks at revenue. Fourth quarter revenue from our global businesses was $605 million higher than last year's fourth quarter. I'll go through each business in more detail in the next few slides. The $944 million reduction in revenue in Corporate Centre between the third and fourth quarters was mainly caused by the valuation difference on long-term debt and associated swaps that I've already described. Reported revenue numbers included a $396 million impact associated with foreign currency translation differences versus the third quarter. On an annual basis, our global businesses' revenue was broadly unchanged.

Slide eight looks at Retail Banking and Wealth Management revenue. Revenue increased by $25 million compared to last year's fourth quarter. Increased customer lending and higher deposits throughout 2016 helped grow fourth quarter Retail Banking revenue by $66 million. Wealth Management revenue also grew by $40 million, driven by investment distribution in Asia. Lending growth accelerated in the fourth quarter, particularly in mortgages in Hong Kong and the UK. For the full year, adjusted revenue was down 2%, as 1% growth in Retail Banking revenue was more than offset by a fall in Wealth Management. This was principally caused by the impact on our investment business of reduced client activity in Hong Kong, particularly in the first half of the year.

As slide nine shows, Commercial Banking revenue was broadly stable compared to last year's fourth quarter. We continued to see strong balance sheet growth in the fourth quarter, with $6 billion of additional lending and a further $11 billion of deposits. This contributed to a 5% revenue increase in Global Liquidity and Cash Management compared to last year's fourth quarter. TLAC costs and the impact of market movements in Asia on insurance revenue caused revenue in 'Other' to fall by 16%. For the full year, Commercial Banking revenue rose by $134 million, or 1%. This included growth in Global Liquidity and Cash Management of $181 million driven by increased balances and wider spreads in Hong Kong. Credit and Lending also increased by $83 million, reflecting continued loan growth in the UK. These were partly offset by lower revenue in Global Trade and Receivables Finance.

Global Banking & Markets had a strong fourth quarter, increasing revenue by 23% year-on-year. Foreign Exchange, Rates, Banking and Global Liquidity and Cash Management all grew revenue, capitalising on increased client flows and market movements. For the full year, Global Banking & Markets revenue rose by $353 million, or 2% compared to 2015. This included a net negative impact of $297 million related to adverse movements in Credit and Funding valuation adjustments. Excluding these movements, revenue rose by $650 million, or 5%, mainly in Rates and Credit, as we gained market share in Europe. Revenue also increased in Global Liquidity and Cash Management, as we grew average balances and benefited from wider spreads. This was a good performance from Global Banking & Markets. Since 2014, adjusted risk-weighted assets in Global Banking & Markets have fallen by 14%, and revenue has risen by 10%. This demonstrates the effectiveness of both our risk-weighted asset reduction programme and our targeted investment in the business.

Slide 11 looks at Global Private Banking, which saw a fall in revenue of $43 million, or 10%, compared to last year's fourth quarter. This largely reflected the continued repositioning of the business and reduced market activity. During 2016 we disposed of Private Banking businesses in Bermuda and Brazil, and a client portfolio in Europe. These disposals are reflected in the fall in client assets during the period. The repositioning of Global Private Banking is now substantially complete. For the full year, adjusted revenue fell by $208 million, or 11%. We attracted more than $5 billion of Net New Money from collaboration with our global business customers in 2016.

Corporate Centre revenue fell by $944 million compared to the fourth quarter of 2015. This was principally due to a net $616 million reduction from adverse valuation differences on long-term debt and associated swaps, and the loss of revenue from the run-off of our US CML portfolio. Balance Sheet Management revenue rose by $133 million, or 21%, against last year's fourth quarter. Balance Sheet Management for the full year was up by $175 million, or 7%. We reduced the remaining US run-off portfolio by 49%, which contributed $8 billion of the $22 billion RWA reduction in the fourth quarter. We expect to complete the disposal of the CML assets during 2017.

Full year net interest margin of 1.73% was 15 basis points lower than 2015. Eight of those basis points came from the disposal of our operations in Brazil and currency translation differences, particularly in the UK and Mexico. The remainder came largely from lower yields on customer lending, including revenue lost from the run-off of our US CML portfolio and an increase in the cost of debt, including around

$400 million of TLAC interest costs.

Slide 14 looks at operating expenses. Our operating expenses, excluding the bank levy, increased by 5% from the third to the fourth quarter, reflecting a small number of specific items. These included a write-off of around $150 million relating to software that we no longer use, and a spending increase related to marketing programmes launched in the fourth quarter. Our cost performance in 2016 was excellent, with a $1.2 billion, or 4%, drop in adjusted operating expenses. We removed $2.2 billion of costs from the business in 2016, bringing the total annualised run-rate savings since we started our cost saving programmes to around $3.7 billion. Our UK bank levy charge was $499 million lower than in 2015, including a positive adjustment of $128 million relating to the previous year. These reductions were partially offset by the impact of inflation and further investment in regulatory programmes and compliance. Our total expenditure on regulatory programmes and compliance was $3 billion, which was around $400 million, or 14%, higher than in 2015. We expect an increase of more than 10% in regulatory and compliance costs in 2017.

Slide 15 walks you from 2014 operating expenses to a revised 2017 exit run-rate target. While we're investing more in regulatory and compliance programmes, we're also continuing to invest in growth and improvements within the business. We will more than pay for this investment through additional cost-savings, which will require additional one-off investment to remove these costs from the business. We've already invested around 90% of the amount that we originally said we would by the end of 2017 to achieve our targeted cost savings and improve the operating capabilities and productivity of the Group. We now expect to invest a total of $6 billion by the end of 2017 to achieve total run-rate cost savings of around $6 billion - around $1 billion above the top end of our investor day target range.

Slide 16 looks at loan impairment charges. Fourth quarter LICs were down $83 million on the third quarter of 2016 and down $825 million compared to fourth quarter of 2015. Fourth quarter LICs for 2016 had no outstanding features, and the credit outlook remains benign. This is in no small part due to the strength of our risk management and portfolio repositioning since 2011. In 2016 as a whole, loan impairment charges were $48 million higher than 2015 due to a small number of individually assessed LICs in Global Banking & Markets relating to the oil and gas and mining sectors in the US in the first half of the year. There were also higher charges in Retail Banking and Wealth Management, particularly in Mexico, as we grew our market share of retail and consumer banking products. These increases were mostly offset by a large reduction in Commercial Banking charges.

Slide 17 breaks down adjusted profit for 2016 by global business and geography. The overall story is unchanged since the third quarter. Adjusted profit before tax was down by $228 million, or 1%, due to lower revenue and marginally higher loan impairment charges, but this was largely offset by good progress on costs. The effectiveness of our cost reduction programmes means that we achieved positive jaws of 1.2% in 2016, in spite of the tough revenue environment.

We generated a further $38 billion of risk-weighted asset reductions in the fourth quarter, bringing total reductions for the year to $143 billion. $17 billion of the fourth quarter total came from Global Banking & Markets and Legacy Credit, $8 billion came from our US CML run-off portfolios, $5 billion from Commercial Banking and $8 billion from 'Other', mainly Balance Sheet Management. The total reduction since the start of 2015 now stands at $267 billion, around 44% of which came from Global Banking & Markets and Legacy Credit. This takes us more than 97% of the way towards our target, which we expect to exceed through continued focus on efficient capital deployment.

Turning to capital, the Group's common equity tier one ratio was 13.6% on 31 December, compared with 13.9% at the end of the third quarter. Common equity tier one capital reduced by $9 billion in the fourth quarter, due mainly to foreign currency movements, dividends and a reported loss for the period. The impact of this reduction on our common equity tier one ratio was mitigated by the reduction in risk-weighted assets. Today's buy-back announcement reduces the common equity tier one ratio to 13.5%.

Slide 20 looks to the year ahead. Our financial targets maintain our focus on improving returns, delivering cost productivity consistently and providing sustainable returns to shareholders. Our medium term revenue prospects remain good, supported by loan growth and strong deposit growth in 2016, and steeper yield curves and rising interest rates in the US and Hong Kong. Our restructured business is increasingly well positioned to capture further opportunities, and our global businesses look to have carried momentum from the fourth quarter into the start of 2017. We have traction in our cost management and productivity improvement programmes, with persistent focus on improving returns supported by a continued commitment to capital efficiency. Uncertainty in the geopolitical and regulatory environments remain considerations. There are also a number of near-term revenue headwinds that are worth bearing in mind. Restating 2016 reported revenues based on average January 2017 foreign exchange rates would reduce them by $2 billion. Clearly costs benefit from such FX movements. We expect around $500 million of additional TLAC interest costs in 2017, and a potential $300 million revenue impact from lower UK interest rates. It's also worth remembering that while the run-off of our US CML legacy portfolio is clearly good news, we will lose the revenue associated with the assets that we sell, as well as the associated impairment losses.

Stuart Gulliver

Slide 21 shows our progress in implementing the actions we outlined at our Investor Update in June 2015. We're now 18 months in to a two and a half year programme, and the large majority of actions remains on track. We are going to beat our original targets to reduce both risk-weighted assets and costs, as Iain has already said. Mexico also continues to recover strongly. Adjusted PBT more than tripled in 2016 and revenue grew 18% year-on-year. We grew lending by 14%, increasing our market share of personal loans, payroll loans and mortgages, and raising our advances to deposit ratio. We also grew Global Trade and Receivables Finance and Global Liquidity and Cash Management revenues in Mexico by 11% and 19% respectively.

The low interest rate environment continues to keep the US business off-track, although adjusted revenues in Global Banking & Markets and Retail Banking & Wealth Management both grew in 2016. The network benefits of the US business have also increased, as we grew revenue from the international subsidiaries of our US clients by 11%, compared with 2015.

The establishment of the UK ring-fence bank remains on track. Both the Chair and CEO positions of HSBC UK have now been filled, following the announcements of Dame Clara Furse as Chair and Ian Stuart as Chief Executive. The migration of roles from London to Birmingham is around 35% complete, with the remainder on track to be in place by the time the bank launches in 2018. Our international network continued to drive revenue growth in our transaction banking product lines. Global Liquidity and Cash Management revenue increased by 6% year-on-year, and Global Trade and Receivables Finance captured further market share in strategic markets, including Hong Kong and Singapore. In 2016, we were named 'Best Bank for Corporates' by Euromoney and 'Best Supply-Chain Finance Bank' at the Trade Finance Awards.

We continue to invest for growth in Asia. We launched a new digital banking platform for SMEs in Guangdong, we're growing business around the China-led Belt and Road initiative, and we were named 'Asia's Best Investment Bank' and 'Asia's Best Bank for Financing' by Euromoney. Assets under management in Asia increased by 11%, and we grew revenue from the international subsidiaries of our ASEAN region Commercial Banking clients. We continue to be the leading bank for international renminbi products and services.

We are better protected from financial crime because of our investment in our Global Standards programme. Our Monitor has raised certain concerns, but we have continued to progress and our commitment remains unwavering. By the end of this year, we're on track to have our AML and Sanctions Policy framework in place, and to have introduced major compliance IT systems across the Group. Beyond 2017, we will continue to work to fine-tune those systems and ensure that our improvements are fully integrated into our day-to-day risk management practices.

To conclude, I'd like to leave you with four points. First, our strategy is working. Our global businesses are performing well in challenging operating conditions. Our international network - our main differentiator - is delivering more than 45% of client revenue. We're capturing market share in strategic areas. We have an unrivalled business in Asia, with strong returns and good momentum. And we've delivered positive adjusted jaws in 2016 and expect to do the same in 2017.

Second, we're doing what we said we'd do. We're going to exceed both our original risk-weighted asset and cost reduction targets. We sold our Brazil business, which allowed us to complete the first share buy-back in our history, and to announce today a second buy-back of $1 billion. Our Mexico business is being turned around quickly and effectively. And our investment in Asia is delivering more revenue for the Group in strategic areas.

Third, more than ever there's a big advantage in being a diversified, global bank. The complexity of the current environment, and the potential difficulty in connecting customers with strong growth opportunities naturally benefits a bank with our network and heritage. The world is evolving into big regional trading blocs with less global trade, but vastly increased regional trade - and the areas where barriers are falling fastest are the regions where HSBC is strongest. Our long-standing (and growing) strength in infrastructure and project finance in Asia and Europe also positions us perfectly to capitalise on opportunities arising from the China-led Belt and Road initiative and the rising prominence of green finance.

Finally, we remain a well-funded business with strong capital generation, a diversified balance sheet and an excellent record of delivering value for shareholders. Last year we delivered a total shareholder return of 36% in Hong Kong dollars, while building a common equity tier one ratio of 13.6%. We've maintained the dividend in 2016, and we're confident of doing so for the foreseeable future.

We will now take questions.

Ronit Ghose, Citigroup

Can I just pick up on a couple of points relating to revenues? Q4 seemed to be a bit of a disappointment vis-à-vis market expectations. Maybe just bad at forecasting. But you're highlighting lots of 2017 challenges while talking up the medium term, and if we can just dig into this, please. On, specifically, the growth outlook, you say you're very well positioned – you're well positioned for growth. In Asia, loan growth's running at about 4% right now in Asia for you. Do you expect that run rate to accelerate from 4%? In your statements you've mentioned some the leading macro indicators are picking up, trade's picking up, yet it's pretty uncertain in terms of outlook. I'm just wondering in terms of 4% loan growth can be stronger in your Asian footprint this year. Linked to that on the revenues, is most of the underlying margin weakness that you've seen in Q4 down to loan spreads coming down, and how much more pressure do you expect on the spread in the UK and the US, and particularly in the UK?
And finally, on the one-offs, there's a $1 billion swing in Treasury that Iain's obviously called out, and I'm just curious as to why you're not putting that into the one-offs. You say that you expect this to net to zero over time. How should we think about that Treasury revenue number?

Iain Mackay

Stuart can provide some context around this. We've clearly got good, very strong loan growth coming through Global Banking & Markets, and we saw encouraging trends in the Retail Bank as well in the fourth quarter of last year, with some momentum coming in to 2017. But I think the growth rates that you refer to around 4% to 5%, are probably in line with what we're presently seeing and what we would expect to see through 2017 in that particular area. Moving on to margins, there's a couple of factors coming through in the fourth quarter. You will notice, and we commented here, that again we've got accelerated reductions in our US CML run-off portfolio in the fourth quarter. And notwithstanding that that historically has been a loss making portfolio, it is a very strong NIM portfolio. And as we continue to sell and run-off those assets, that feeds through to NIM. The other factor that we saw in the fourth quarter was the impact of the MREL or TLAC, depending on what you want to call it, coming through in the fourth quarter, having issued last year over $31 billion worth of instruments into the marketplace to meet those regulatory requirements. Another factor that was an influence in the fourth quarter was the impact of the bank rate reduction earlier in the year. That was certainly reflected in the fourth quarter. And I think those are probably two of the main features that come through in that regard.

Stuart Gulliver

Yes, quite a big FX impact coming from the weakness in the Mexican peso, the Chinese renminbi, the Egyptian pound and, of course, the UK pound. Which, also, as you translate them into US dollars has a negative impact. But loans and advances actually grew quite strongly in the fourth quarter, which, as I say, is why we can see some revenue growth, but not above the 4% - 5% handle. The specific thing that caused a lot of the miss against analysts' estimates in the revenue line is specifically around debt issued, and Iain should just talk about that a little bit as to why it's not in significant items.

Iain Mackay

If you look at the total year impact, so have a number of long-dated bonds outstanding, part of the overall funding structure for the Group. Those are fixed rate instruments swapped into floating, because the majority of our book is floating rate. And they are matched, economically, across the duration. The bond is valued off a LIBOR curve, and the swap, by convention, is valued off the overnight index swap rate, and there's a little bit of divergence that came through in that regard, which impacted more in the fourth quarter than had been the case over the course of the year. If you looked at the total year, the impact was less. It was about $270 million for the full year impact. We haven't historically seen a great deal of volatility coming through this. We don't really do anything particular from a forecasting perspective for the reasons that I described: if we hold these bonds and the economic hedge against them through to maturity, the impact should broadly migrate towards zero. This has really been a relatively insignificant feature within the P&L and within the revenue line over recent quarters. Whether we re-classify this going forward I think will largely depend on the volatility that we see coming through this. But, to be clear, we'll provide insight to it when we do see it coming through every quarter.

Ronit Ghose

Can I just have a quick supplementary on the RBWM revenues. You called that out as well. You mentioned there's a weakness in Wealth. Is that client activity or traditional life insurance type returns, like an investment return weakness in the fourth quarter? Is it client volumes were slowing in the fourth quarter?

Stuart Gulliver

No, it's actually the first half, and actually it was because we had an incredibly strong first half of 2015, largely because of the Hong Kong Shanghai Stock Connect. And then remember the first quarter of 2016 was a really slow start and quite difficult for everything related to capital markets generally. That created weakness in the first quarter/first half in Wealth Management, particularly in Hong Kong, and the second half never made it back up.

Ronit Ghose

But it looks like – maybe I misread it, but it looks like Q3 was really strong and Q4 was a bit weaker, a couple of hundred million weaker quarter on quarter in Hong Kong Wealth, or in Asia Wealth.

Iain Mackay

No, I think what we saw coming through were fairly good numbers from a Retail Banking perspective.

Stuart Gulliver

Rather than the Wealth piece. So Hong Kong, there's big growth in deposits, big growth in net interest margin on deposits in the Retail Banking space.

Iain Mackay

Yes, and I think what we also see seasonally within the Asian business, with Hong Kong in particular, is a little bit of repositioning around the end of the year. So from an investment distribution perspective, the revenue was down slightly in the fourth quarter versus the third, but nothing of particular note.

Alastair Ryan, Bank of America

The net interest margin, just to come back to that, was 175 basis points in the first half, 173 basis points for the full year. How should we think about the exit run rate, and how quickly the December dollar rate hike starts to outweigh the earlier in 2016 rate cuts in places like the UK? Second, Iain, just on your comments on the CML, you're quite clear you hope to be out about in 2017. Did I understand correctly that the entities will be gone as well then, because clearly in the past they've been a big consumer of stress test capital for you? Thirdly, just on your comment on slide 20: 'An encouraging start to the year'. Can I encourage you to quantify 'encouraging'?

Iain Mackay

On NIMs, going back to it, taking the fourth quarter discrete, the NIM in the fourth quarter was 160 basis points. If you take out the annualised effect of Brazil, on a year-to-date basis through the third quarter you take out the annualised effect of Brazil, that's 10 basis points. You then have about a five or six basis point move between the third quarter and the fourth quarter. That's contributed to by a little bit of asset compression coming through UK mortgages. Last year was a pretty competitive environment for UK mortgages. We competed in that market more broadly, strengthening our presence in the broker channel. So we saw a little bit of spread compression coming through there. At the end of the year, and the beginning of this year, you probably noticed there was coverage of the fact that some of the better priced products in that space had been withdrawn just as we responded to some of the pressures in that area. Other factors coming through I've already mentioned: run-off of the CML portfolio and TLAC costs. But the discrete fourth quarter was 160 basis points.

In terms of CML, we'll have substantially all of the assets, and by that I mean we expect to be well under $1 billion of remaining unpaid principal balances, probably around $300 million to $400 million of unpaid principal balances outstanding, by the time we get to the half year. When you reflect on that from a CCAR and a DFAST stress testing perspective in the US, it's the asset portfolio that's caused the stress. It's not the existence of the legal entity. So what we would expect to have accomplished by the half year is substantially all the assets to be gone, and the process of winding down the legal entities has, in actual fact, already commenced. That is a state by state regulated business in the US, and as we come out of a state and have no further loans outstanding, we start rationalising those legal entities. And clearly, for a number of years now have been rationalising the infrastructure supporting that business. But the cause of stress coming through CCAR and DFAST was the asset portfolio, so as that goes the opportunity to be stressed in that regard will go with it.

And in terms of 'encouraging', on slide 20, as you say, we've laid out some of the short-term pressures that we see. Clearly foreign exchange movements had an adverse impact on revenues last year. Those rates didn't particularly move in an encouraging direction in an early part of the year. We've got just over $31 billion of MREL instruments out in the market last year. Consistent with previous guidance, we've got somewhere between $60 to $80 billion to do in total, so 2017 should be a reasonably big year in that regard once again, and there'll be some cost associated with that. Lower UK interest rate, that's just really the full year impact of what we saw happen on the bank rate earlier in 2016. And then there's the CML. But we do see those as largely being short-term influences. What we have seen, and we talked about it earlier, is the growth coming through the Asian business, notwithstanding some of the geopolitical uncertainty in the UK. That business performed well in Commercial Banking and Global Banking & Markets over the course of 2016 as well, and is hopefully carrying some momentum into 2017. So I am, in the round, reasonably optimistic, but we do have some short-term revenue headwinds to deal with.

Stuart Gulliver

Just to add, the rate rise in December probably adds about $300 million to the NII for 2017, and about $500 million to $600 million in subsequent years. We've assumed two rate rises in this year, but in the second half of the year. So if we get a rate rise in March that will be an earlier benefit for us. January was a strong month. GB&M had a strong January, but it's the type of business that you can't really extrapolate. But it had a strong January, and so did RBWM as the impact of higher rates came through the deposit base, which is essentially the number I've just mentioned.

Chirantan Barua, Bernstein

Iain, you mentioned about the CML portfolio and the wind-down. We've always been interested in the excess capital there. You've announced a $1 billion buy-back right now from your Brazilian proceeds. How should we think about that excess capital? When do you hear from the Fed next, and when will you communicate with the street with regards to what you do with capital repatriation from the US? Second, the rate in compliance cost just keeps going up and up. It's a significant item, and I know that you've brought in a new cost plan. It would be great to understand how do you see that $3 billion - $3.5 billion going forward over the next three - four years? What is sticky and what is not? And the third, a quick technical question. Your rate sensitivity on rest of Asia has gone up sharply from the first half. Is there a liquidity book that you've moved to China, Singapore or somewhere else? Just want to understand what's driving that up-tick in sensitivity.

Iain Mackay

From a CML perspective, or more broadly, US capital, we had, within our CCAR submission for 2016 a dividend proposal from the US holding company to the parent in early 2017, so actually at the beginning of the second quarter in 2017. That capital plan raised no objection from the Federal Reserve, so we would expect that dividend to proceed early in the second quarter of this year. When that does proceed we'll let you know what the number is. Broadly speaking, we've described having in excess of $8 billion of surplus capital in the US, and that's been informed by the portfolio repositioning over the course of the last few years, the disposal of the credit card business back in 2012/2013, the run-off of the CML portfolio, the overall reshaping of the business. I think we've also guided the expectation in terms of being able to move the surplus capital out of the US, whilst clearly continuing to invest appropriately in the growth of our US business. The surplus capital position is something that's likely to take three to five years to resolve. And certainly one of the things that informs that, in fact the key thing that informs that is us continuing to be successful in our CCAR submissions. Our next one will be on 1 April this year. And ensuring that we continue to improve our overall capacity to plan, forecast and manage the capital position within our US business. But I think we certainly remain very confident in terms of being able to get the capital position in the US to an appropriate standing with respect to the risks and the business that we run in the US, and thereby repatriating capital to the parent company. But we'll keep you posted.

Stuart Gulliver

On regulatory programmes and compliance, as you noted the total expenditure was about $3 billion in 2016, so about $400 million higher than 2015. Of this, the spend on global standards was about $1.6 billion in 2016, within that $3 billion number. Probably the expenditure on global standards peaks in 2017. We expect the implementation of systems and IT platforms to enable us to scale without costs going up incrementally. However, this is part of our BAU, so I would not expect us to see a material reduction in that $3 billion number either. But as I say, 2017 should be the peak number, but then I would expect us to see that repeat in future years.

Iain Mackay

Going back just momentarily to your capital question: The capital that comes back to the parent company in the form of dividends, capital transactions like the Brazilian disposal, any dividends that we would receive from the US legal entity or any other goes into the general capital pool of the parent company. And the deployment of that is focused on investing to grow the business, supporting the dividend to the shareholders, and as we've said, from time to time, as appropriate, we'll consider buy-backs. I wouldn't necessarily link any of the capital actions specifically to buy-backs or anything else. It becomes part of the general pool, which Stuart and the management team, along with the Board, then make decisions around how that is attributed to the various priorities.

Stuart Gulliver

If you look at the Asia-Pacific rate sensitivity, pretty big growth in deposits in China. Remember, China sits in that Asia Pacific number. Big rate move down in China on that deposit base, so much more rate sensitive. There's no book being moved.

Raul Sinha, JPMorgan

First question on the rate sensitivity again. I think you've been very clear on the short-end of the curve, and the sensitivity to that, but you also mentioned the steepening of the US and Hong Kong yield curves. So I was wondering if you can maybe talk a little bit about the sensitivity to mid- or the long-end of the curve, and how you might be positioned, or changing your positioning around that, especially in Q4?

Iain Mackay

Again, not much really. When you think about where the US dollar rate really rose in the second half of last year it was at the long end. It was really 10 years and beyond. When you look at the asset composition of our balance sheet, a relatively small proportion of the balance sheet is longer dated, with the majority really sitting below five years. So although clearly steepening of the curve helps us, it's going to take longer to work its way through the asset base and really result in materially higher revenues. What helps us most are policy rate increases and movements in the shorter end of the curve.

So rate steepening helps, but it doesn't have the same impact as things at the shorter end.

Stuart Gulliver

The way to think about Balance Sheet Management is it's three years and under. If the one month/three years is steep, we get a lot of money riding down that curve. But think about it three years and under. So what the 10 year and 30 year does is not that relevant.

Iain Mackay

Broadly speaking, in a rising rate environment, you're generally going to see improvement coming through the businesses, Retail Banking & Wealth Management, Commercial Banking, Global Banking & Markets, with a possible downside to that within Balance Sheet Management. But by the same token, you'll have seen highly consistent earnings coming through Balance Sheet Management over the course of the last four or five years, where it has consistently fallen within the $2.5 billion to $3 billion range, with 2016 being at the upper end of that range.

Raul Sinha

Second question. We haven't talked about asset quality in the call, but obviously this was a very good quarter. I think you had some write-backs in Q4 as well. But clearly, some of your peers have had different experiences more recently, and obviously you've got quite a low risk profile in the balance sheet. I was just wondering if you could talk a little bit about what's the real underlying run rate you see in terms of provisions, and what your thoughts are in terms of the outlook. Can it get better from this or is it as good as it gets?

Iain Mackay

We had a quick call with our colleagues in Hong Kong over the weekend and the story's been remarkably consistent in terms of asset quality across Retail Banking & Wealth Management, Commercial Banking and Global Banking & Markets. The year was clearly impacted by higher provisions in the metals and mining and oil and gas sectors, principally in our North American businesses. But that being said, we saw some credits coming through in the Commercial Banking business in those sectors as the year progressed. But credit quality, whether you look at China, Hong Kong, the wider Asian region, the UK or Europe, remains very, very stable, and there are no really adverse indicators at this point coming through the book. At this point we haven't seen any impact from Brexit. So I think overall credit quality remains stable. We did get some credits coming through in the fourth quarter, which gives us probably a slightly artificial view. But again, we're at a fairly benign point in the cycle. I am, as you know, notoriously disinclined to forecast loan impairment charges (LICs). But again, if you take account of where you saw oil and gas, metals and mining exposures being dealt with by us in the course of late 2015 and 2016, and normalise for that, you get some sense as to where the run rate might be.

Raul Sinha

Iain, any thoughts on IFRS 9 and how that might change, in terms of should we start to think about that from 2018 in terms of your provisioning?

Iain Mackay

Well, the industry's certainly thinking about it. I think the most important areas to think about are how it affects capital and volatility within the capital ratio. Over the life of a loan, provisioning shouldn't change and if we maintain consistent underwriting and discipline in terms of how we manage the book, it should not change the lifetime loss experience. However, the timing of when impairments get recognised from a stage one, stage two, stage three perspective in IFRS 9 clearly could – almost certainly will – introduce some volatility. And if you were to see significant sectoral downturns – again I'll refer back to what we saw in oil and gas at the end of 2015 – that would move quite a lot of the book into stage two, and you'd see some quite significant upward movement in loan impairment charges. But from a lifetime credit cost perspective, it shouldn't change, unless we allow that short-term volatility to filter through to how we actually underwrite and manage the exposure. If you step back from the standard itself, I think the area where our regulators are only just beginning to think about, is how that reads through to potential short-term volatility in capital ratios and how they deal with that. Look, the industry is going full steam ahead in implementing this standard. It goes in 1 January next year. You will see volatility. In theory what you'll see is credit losses recognised much, much earlier in the cycle. Whether that, necessarily, is a good thing remains to be seen. But lifetime impact should remain reasonably consistent.

Raul Sinha

When do you think we might get some guidance in terms of the impact of the up-front impact for IFRS 9?

Iain Mackay

Second half.

Claire Kane, Credit Suisse

A couple of follow up questions on the revenue outlook, please. Firstly on the NIM, I think you said 160 basis points for Q4. Did you say that the like-for-like sequential impact was -5 basis points, so Q3 was 165? Also, could you explain whether there was any hedging impact in there, or was that 5 basis points broadly related to just the UK? And then my second point is on the MREL or TLAC guidance. You've said it would go up to $0.9 billion for 2017. Can you confirm that that is a long-term run rate, or should we expect there to be an additional impact going into 2018 and beyond if you need to be MREL compliant by 2021? And then finally, my third question, just really to wrap it up, clearly some of the headwinds you flag in terms of FX broadly relate to the first half of 2016. So if we consider the second half adjusted revenue run rate of around just under $49 billion, consensus is looking for around 6% uplift year-on-year versus that run-rate. Given your commentary around volumes, do you think that's reasonable in the context of the NIM pressures? Thank you.

Iain Mackay

To be clear, the 5 basis points – you're right, it was a 5 basis points impact, influenced by the factors I mentioned earlier in the call. Compression in UK mortgages was one of the contributors. That was about 2-3bps quarter-on-quarter from UK mortgages. TLAC and CML run-off were the other contributors. There was no real notable impact from hedging coming through in the fourth quarter. It was informed by assets on the balance sheet and movement within that.

From an MREL perspective, the long-term guidance that we've provided is consistent: $60 billion to $80 billion of gross issuance by the end of 2018, subject to firmed-up guidance from our regulators as to exactly how much is required, where it is required to be positioned, the characteristics of it and so on. That is the first threshold. We issued $31 billion towards that target in 2016. Broadly speaking, assuming there's good reception for this in the marketplace, we'd expect to do much the same in 2017. And to the extent that any further issuance is required, we'll complete that in 2018 to reach the first threshold of compliance in 2019. Clearly, as you point out, the final compliance timeline around the full implementation of MREL is 2022. I think based on regulatory guidance we have today the $900 million NII impact is broadly correct, but again it's subject to whether or not there is more that needs to be done. And I think we really need greater clarity and guidance around quantification and characterisation and treatment of MREL from our regulators, not only in Europe but further afield.

In terms of overall revenue outlook for 2017, we've given you some pretty good guidance around what we think the FX impact is. There are other short-term pressures that we've highlighted, but we've also talked to the kind of growth that we see coming through the business, and what we've seen, certainly in the fourth quarter and the first few weeks of 2017, has been encouraging in that regard.

Claire Kane

In terms of the NII trajectory versus the Q4 run-rate, do you think volumes would more than mitigate the NIM pressure that you've guided to relative to the Q4 base?

Iain Mackay

We will certainly be focused on the management of the assets that we underwrite. Our teams in BSM do a great job of managing the overall liquidity portfolio and interest rate risk in the book for us. So our focus will be on trying to mitigate NIM pressures and continue to grow volumes to offset that, but also to grow volumes in a way that accrete returns for the business. That's a discipline which Samir Assaf and his colleagues, Noel Quinn and his colleagues, and John Flint and his colleagues are very focused on:

putting business on the books that bring improved returns against risk-weighted assets, and returns on equity in the business. I think when you look at the return on risk-weighted assets, and the improvements that Global Banking & Markets have realised, that Commercial Banking have realised, that is encouraging, and that's a discipline that's going to remain in place.

Tom Rayner, Exane

Can I just go back to the share buy-back announcement, because you're fairly clear that this is a first-half buy-back, and it's very much linked still to the capital release from Brazil. My question is, once we get to, say, the interim stage this year, the CCAR is behind you and assuming there's no problems with any of that, is it fair to assume that then it's like a clean page for the rest of the year? We shouldn't take this $1 billion necessarily as a proxy for what you're planning to do for the year as a whole.

Stuart Gulliver

As we evidenced last year, we're starting to manage our capital in a much more active way than we've been able to do previously, because at 13.6% – 13.5% after this buy-back, we are in a good position. First of all, we're trying to not have surplus capital, but actually use it within the business by putting on risk-weighted assets at accretive returns. If we can't put them on at accretive returns, and assuming that we're nicely covered on the dividend, it's possible, subject to regulatory approval, that we might look at doing further buy-backs. But the first priority has got to be to see if we can actually put the capital to work within the business. And that will be the huge focus of all of the teams. The focus of the teams is not to see if we can buy-back. The focus of the teams is to see if we can get accretive RWAs deployed within the business. So yes, I think the way you characterised it, that when you get to the interims it's a blank sheet of paper, is the way to think about it. But I don't want you to raise expectations and start modelling perpetual buy-backs. We won't be doing that. If we actually do see reasonable growth coming around, if we see higher interest rates, as I said earlier Balance Sheet Management, the whole series of books makes a lot of money in the nought to three year area, we get steeper curves, and we'll actually be using that capital up in the business.

Tom Rayner

On the revenue headwinds, just a little bit more colour. You mentioned TLAC. I think, Iain, you've said the $900 million for now is the guidance. I'm assuming that the $900 million is a net figure. That's not a cost of the new TLAC which will be offset by some ineligible debt maturing.

Iain Mackay

That is the negative carry we've talked about. Clearly, the focus within the business is to find ways of deploying that higher cost debt in a way that we can mitigate that negative carry to the extent possible. So again, that's a focus in which Balance Sheet Management is zeroed in, and clearly we bring the expertise to bear from Stuart's experience as well as Samir and the teams in terms of how we mitigate that. But that is negative carry that we're projecting.

Tom Rayner

And then just on the FX, you flagged up the $2 billion headwind if rates stay at the January level, but obviously, as it works through the P&L it's going to affect the other lines as well. How will that drop down to pre-tax or even net income in terms of the headwind? Will it be the same sort of percentage impact all the way down the income statement?

Iain McKay

We would certainly expect to see some kind of corresponding benefit coming through the operating expenses, which mitigates some of that headwind that we see coming through revenues from FX. So if you think of it in broad terms, perhaps about 30% of it we see having an adverse impact on the P&L, because we get some benefit coming through loan impairment charges and operating expenses.

Tom Rayner

You specifically mentioned the mortgage pressure in the UK. I'm just trying to get a sense of whether you view this as a market phenomenon, or is it a real push for market share by you guys? You're happy to, maybe, trade off that volume margin, or do you think it's the market itself is becoming more competitive?

Iain Mackay

Well, certainly this is an area where Francesca McDonagh and Antonio Simoes in the UK could give us much more insight and detail around what's happening on a day-to-day basis. But it clearly was a competitive market in 2016, true in 2015. The team in the UK engaged much more actively with selected brokers, to give ourselves line of sight to a larger share of the UK market, and from a volumes and stock perspective, we grew market share in 2016. But it is clearly competitive from a pricing perspective. I think we had one of the best-priced products in the marketplace in 2016 for a significant period of time, and in the latter part of the year or very early this year, we took that particular offering off the marketplace. So it goes back to Stuart's comment. We are absolutely focused on growing our market share in products that we know we can make good returns, but by the same token, there's a very strong focus on return generation within the business and continuing to improve those returns, both in terms of return on risk-weighted assets and the wider capital equation around return on equity. So discipline around that capital deployment is at a heightened and increasing level within the firm.

Martin Leitgeb, Goldman Sachs

My first question is a follow up on earlier comments on the rate sensitivity, and I was just wondering if you could give us a steer in terms of currency denomination of your deposit base, and what percentage of your global deposits are denominated in either US dollars or Hong Kong dollars. Obviously we get some steer of that coming from the booking locations of the deposits, which would imply slightly shy of 50% on those currencies, but I was just wondering if you could give us a steer if that is the right number, if the number could be meaningfully higher in terms of US dollar/Hong Kong dollar deposit exposure.

The second question is to follow up on your previous comment or answer on Tom's question on the UK mortgage space. I get a bit of sense, looking at pricing relative to market, that it feels like something held you back a little bit during the year, in terms of mortgage growth in the UK. It seems also that the growth has accelerated in the second half. I was just wondering if this has to do further with your rollout of intermediary networks, and if we should assume that going forward from here that growth in net new mortgage lending in the UK would further accelerate.

And the final question, also on the UK, but here on the current account side. It seems from what we read in the press that the current account offering at this point in time is very competitive in the UK, and I was just wondering if you could share a bit of detail on the strategy there, because looking at the latest account it looks like there's quite a substantial deposit overhang in the UK, and I was just trying to get a sense of what the aim here is in terms of broadening the current account offering.

Iain Mackay

If I take the last one first, you'll have seen again the advances to deposit ratio, sitting just below 68%. We saw significant customer deposit growth across each of our global businesses within 2016, most notably within Hong Kong, wider Asia and the UK. Customers either like our deposit proposition because of how it's priced, or because of the strength of the HSBC balance sheet and the overall security. I think if you were to split it out from a corporate perspective, it's probably the latter. From a retail customer perspective, I think it's probably more difficult to point to any particular differentiation in that regard.

If you think about overall deposit concentration, the most significant deposit surplus we carry is in Hong Kong. It is the most significant by a long stretch. It is then followed by strong deposit and AD ratios within the UK. Then latterly, if you work down the list, you come to the US as being third in terms of overall concentration of deposits that are either US dollar directly, or US dollar linked. But Hong Kong is the big beast in that equation.

I think in terms of mortgage growth in the UK, there clearly was a focus in 2015 and 2016 on expanding our ability to access more of the market. But in terms of overall growth, it's actually been a fairly steady picture in terms of 2016 versus 2017. We've grown at a reasonably steady pace from the first quarter of 2016 through the second, third and fourth quarters. If you think about it, at the beginning of the year we had slightly less than $93 billion outstanding in UK mortgage balances and at the end of the year we had about $96 billion, and that's on a constant currency basis. So overall, we grew the book, but I wouldn't have called it a headlong charge for growth. But there's a very strong balance between underwriting discipline and doing the right thing in terms of appropriate product for the customers, in terms of the direction of the UK business.

Martin Leitgeb

On the deposit denomination, is this roughly 50%? What is reflective of the US dollar/Hong Kong dollar exposure?

Iain Mackay

Like I said, the Hong Kong dollar deposits, in terms of something linked to the US dollar, is the most significant surplus that we've got sitting around the world. I don't have the breakdown of the deposit base globally for the Group by currency, but we can come back to you on that one.

Jason Napier, UBS

The enlarged gross costs programme and the breakdown of the waterfall there, I just wanted to ask again for a little bit more colour on the inflation and rate costs. At well over $1 billion now, this is the original 10, and some sense to what has changed there. I appreciate the comments on taking it as operating expenses, I'm just interested in the way that things have turned out. And likewise, the very substantial increase in transformational savings that you're aiming for, just perhaps by division where that is coming from, given the size of the numbers.

Secondly, a much easier one, the Corporate Centre costs ex levy look reassuringly stable, at about $250 million a quarter, and I just wonder if an underlying $1 billion a year run-rate for Corporate Centre ex levy was about right.

And then I have a last question on capital. And I'm afraid I'm really asking you to rehearse what I think you already said at Q3 around the change in treatment of BoCom, but if I think about some of the comments today, the buy-back announced today takes you to 13.5% of CET1. The $8 billion of capital that you've mentioned, you've said is potentially excess in the US, is another 100 basis points, and BoCom is worth a little over 100 in Q3. I'm just trying to understand, again, whether the sense from yourselves is that the change in treatment at the PRA level is in the near-term or in the medium-term distributable. Because that would imply a new running deck for capital requirement of 11.5%, which I think many investors might regard as too good to be true.

Iain Mackay

Can you go down your rationale for 11.5%? You're suggesting an appropriate ratio for the Group of 11.5% common equity tier 1?

Jason Napier

I'm just trying to check the maths. So, I think in a response to an earlier question you said that you'd suggested that excess capital in the US was $8 billion, right? So that's 100 basis points. The benefit in Q3 from the PRA's change to the BoCom treatment was 104 basis points. So where you are now, net of those two things, is 11.5%.

Iain Mackay

No, it is the wrong way to think about it. We've set out a common equity tier 1 ratio target of 12 to 13%, and I think for probably the last 12 to 18 months we've been clear that probably at the top end of that range is the appropriate place for us to be, certainly until some of the regulatory uncertainty that still persists is resolved in an appropriate manner. Clearly, it was a little bit disappointing that we didn't get final guidance on Basel III revisions or Basel IV in January. We'll hopefully get something on that later this year. But no, our common equity tier 1 sitting at 13.5% after this buy-back is 50 basis points above the top end of the range that we would target.

Therefore, it comes back to Stuart's comments, that when we have capital resources at the Group that are in excess of our common equity tier 1 ratio, there's a number of factors we'll consider. One, the investment opportunity at improved return levels within the Group, the overall coverage for the dividend, and then consider the opportunity for buy-back. The other factors that clearly flow into that is where we are with respect to overall stability in the regulatory environment as it relates to capital resources, and more broadly dealing with uncertainty from a geopolitical perspective and how that could impact the overall revenue and profit generation within the Group. It is a multifaceted problem that the industry faces, and I think we've got a pretty sensible and sound framework around dealing with that. But do not assume that moving significantly below 13% is something that we would countenance in the short, medium or long term.

From a cost perspective, the overall regulatory and compliance costs go well beyond the implementation of global standards. Global standards are a significant component of that, and, as Stuart pointed out, we continue to invest on delivering our commitments under the US Deferred Prosecution Agreement, and the agreement with the Financial Conduct Authority in the UK. And that is a level of investment we would expect, and certainly Colin Bell, who leads that overall focus for us, is firmly of the view that investment in that area will peak in 2017, and that's consistent with previous guidance we've provided in that regard. Other programmes that fall into that: stress testing – we do multiple stress tests around the world for regulators. We did over 60 stress tests last year, informed by regulatory guidance. We have our own internal stress-testing programme that's been running for many years, that addresses questions Marc Moses, our Chief Risk Officer, Stuart and the Board have, that we stress test against. It also covers implementation of the ring-fenced bank in the UK. It covers the implementation of IFRS 9. It covers CCAR in the United States. So it's a broad base of programmes that are dealt with in the regulatory and compliance space. Implementation of the Senior Management Regime in the UK is another that falls into this area.

The area of expanded investment is primarily within the global standards programme, as it relates to anti-money laundering and sanctions control, and overall financial crime risk management and we would expect that investment to peak in 2017. And as Stuart said, we would expect that to become part of the run-rate. Our view is that we will deliver productivity over time, but we will deliver that productivity over the broader suite of our regulatory and compliance programmes, as opposed to specifically within the global standards programme.

In terms of what's really delivering the cost saves, it's across each of the global businesses, focused both on front office and back office processes. There's a very significant contribution to this from our Technology and Operations teams, in terms of the efficiency with which our Service Centres around the world operate, loading and optimisation of the workforce within those in terms of getting better efficiency in terms of responding to customer requirements, collection activities for example. From a Technology perspective, the overhaul that Andy Maguire and Darryl West have led across the organisation is leading to some significant savings, and one of the consequences you saw from that was the impairment that we took in the fourth quarter against some of the software we no longer deploy within the business. But it is, really, across every aspect of the business, within the supporting functions, across Risk, across Finance we've seen significant savings realised as we improve processes. And really, what we have seen, which has informed the increase of the targets, is not necessarily proliferation of the programmes that we've got delivering those efficiencies, but getting greater yield from the programmes we've already launched. Clearly, there are more programmes being launched, but the main contributor is greater yields from programmes that we've already had up and running, and frankly getting better at this as time goes on. I think the other point to make here, this is not about getting to the end of 2017, dropping the tools, taking a big rest and congratulating ourselves, but it's about carrying that productivity into 2018 and beyond.

Jason Napier

Last question is on Corporate Centre ex levy, about $1 billion a year. That feels like a stable-ish number, does it, as we come to grips with the new division?

Iain Mackay

It's not a bad number for 2017, but just as the rest of the business is focused on delivering cost savings and better processes, our Corporate Centre's focused on the same thing. It's not about number, but we'll be focused on trying to work that a little bit southwards as well.

Stephen Andrews, Deutsche Bank

On slide 7 on the Corporate Centre, and that $1 billion to the year ex levy. Can you just make a comment on the bank levy? It came in a little bit lower than expectations. You said there was a write-back, what would you expect that to be this year? Because I think it was about $300 million better than people's expectations.

Iain Mackay

Yes, so the rate dropped, so you'll recall from the budget in 2015, I think, the rate will drop each year from now to 2021, when the basis of assessment will go from the consolidated balance sheet of the Group to the UK balance sheet of the Group. And it is in 2021 when we will realise a significant reduction in the bank levy, assuming that budget undertaking and legislation remains in place. What you should expect between now and 2020 is somewhere in the range of $1 billion to $1.1 billion for the bank levy.

Stephen Andrews

So net of the bank levy, we should just really be running that Corporate Centre forward to zero? Because it looks like a lot of TLAC costs, the roll-off costs now of the US CML, all this in that Corporate Centre with the new breakdown. Is that correct? Is there any contribution from the Corporate Centre which has been positive in the past?

Iain Mackay

When you say positive, what do you mean?

Stephen Andrews

If we look at slide 7 at the underlying run rates you're giving on the businesses, you've got the global businesses and the Corporate Centre. And the Corporate Centre, as you rightly pointed out in your comments, is at minus $621 million in the last quarter, which was the debt issue. If I'm right, what you're saying just now with the previous question was that we're looking at running about $1 billion for the year, ex the levy, because obviously there's a lot more drags on that going forward as you've pointed out. If you're saying $1 billion for the year, we take off a 1.1, essentially for the full year we should pretty much be forecasting that as zero for the full year at each quarter. I know you don't give forecasts, but is that how we should think about it?

Iain Mackay

From an ex levy perspective?

Stephen Andrews

Yes, including levy full-year, roughly zero.

Iain Mackay

But remember what's going through the Corporate Centre here. You've got the associates, you've got BoCom, you've got Saudi British Bank, you've got Headquarter operating expenses, you've got the net of our Global Service Centres, revenue and expenses coming through that. You've got a proportion of the TLAC costs coming through that, some of which clearly is pushed down to the operating entities as we pre-position that. So there are still clearly those very active flows coming through the Corporate Centre. The best analysis is that ex levy is from an operating expense perspective, subject to comments I made, probably $1 billion.