Transcript

Fixed Income Analysts Call

Q2 Results

5 August 2019, 2.00pm BST

Corporate participants:
Ewen Stevenson, Group Chief Financial Officer
Iain MacKinnon, Group Treasurer
Greg Case, Head of Fixed Income Investor Relations

HSBC

Ewen Stevenson

Good morning or afternoon, all. It's Ewen here, the Group Chief Financial Officer. I'm joined today by Iain MacKinnon, our Group Treasurer, and Greg Case, Head of Fixed Income Investor Relations. There's a fixed income specific slide pack available on our website. We don't plan to speak to the specific slides in our introductory comments. We'll keep the comments brief, I know many of you, most of you will have had the chance to dial into our equity call this morning, UK time. For me to quickly run through a few high-level points, and then I plan to hand over to Iain for more detail, before opening up for your questions.

On our first half results, continuing to show positive momentum. We had good, robust top-line volume and revenue growth in the first half. We had adjusted revenue growth of 8%, and this excludes the $828 million dilution gain from our Saudi associate that did flatter our reported revenues this quarter. Costs were better controlled relative to 2018, and the first half adjusted cost growth was 3.5%. That compares and is down from 5.6% for the full year in 2018. And that reduction was achieved even though we increased investment in the business, with overall investment up 17% compared to the first half of last year.

Returns were up in the first half, a return on tangible equity of 11.2%. That drove earnings per share up 6 cents to 42 cents. Credit conditions remained below long-term trends, with credit charges of $555 million, or 22 basis points, in the second quarter. I would, however, continue to caution on the UK, in particular. It remains the market we're most focused on. UK positioning will remain sensitive to forward economic guidance, which, given the uncertainty around Brexit, has considerable potential to diverge in the second half.

We also announced today a $1 billion buyback. We think this creates the right capital management balance between continuing to execute our commitment to neutralise scrip issuance over the medium term, whilst being appropriately conservative given Brexit uncertainties on the horizon.

With that, I'll pass over to Iain for more detail.

Iain MacKinnon

Hello, everyone. As Ewen said, the balance sheet remains characteristically strong. The CET1 ratio is up 30 basis points and gives us significant headroom above what we consider to be our regulatory minimum. We continue to enjoy a significant deposit surplus across the group, with a loan-to-deposit ratio of 74%. Our published group LCR declined 18% in the half; however, this was driven by more detail in the technical calculations, rather than an underlying change in the liquidity of the group. If you look at page 14 of the slide deck, you'll see that the funding and liquidity analysis across the main legal entities is very, very strong.

During the first half of the year, we issued $8 billion of MREL, and I had anticipated that we would have to issue some more in the second half. We were thinking of maybe another $5 billion in the second half, to bring us up to the low-teen number that I know Greg had indicated to a number of you. Because of the reduced buyback, additional capital risk coming out of the US, a reduction of MREL requirements in the US, and generally a slightly increase in profitability that fed through to the parent, this has meant that we are doubtful that we will have significant issuance, if any at all, in the second half. Our plan is still to issue around $2 billion of AT1 before the close of the third quarter, subject to market conditions.

A number of you are aware that we've had to update our Pillar 3 disclosures. This was a voluntary disclosure required by the Bank of England. Hopefully you'll find some analysis in there that is helpful when you analyse how we set up the group.

There's been no real impact on our analysis, with regard to CRR2, with the one exception that $9 billion of Tier 2 securities that were previously considered fully eligible are now grandfathered to June 2025. I'm sure I can take questions on that later, but I just wanted to draw that out. As it stands, this change doesn't impact our Tier 2 issuance plans, as we have an excess at the moment.

I think with that, the main points that we want to just emphasise, as we're getting close to the end of our MREL buildout, we're well ahead of where we need to be at the moment. We have $77 billion of MREL-eligible bonds; $69 billion are permanently grandfathered and $8 billion are fully-eligible.

I think there's still a number of moving parts we need to finalise before we get a firm view of our end-state MREL requirements, largely related to the European Resolution Group, and we are talking to the Bank of England about this. The uncertainty isn't coming from HSBC. A lot of it is just to clarify the requirements from the regulators. We've obviously very confident we'll hit our end state requirements, given where we are at the moment.

It goes without saying that our holdco will continue to be the sole issuer of MREL and reg capital, and our opcos will continue to issue senior and secured debt for funding purposes. We've had a number of notable issuances in France, Canada, Hong Kong and the UK, and we're grateful that a number of you have participated in these.

Back to you, Ewen

Ewen Stevenson

Thanks, Iain. If we could now start the Q&A session, please.

Robert Smalley, UBS

Thanks for holding the call in a US-accessible time, greatly appreciated. Just a couple of quick questions. One, just to restate on senior holdco for the rest of this year, you're now moving from five-ish to zero? That's number one. Second question, on AT1s: with your stock buyback announced, does that block you out of the market from issuing AT1s? I think this was mentioned on a prior call. And in terms of timing, when do you think you'd get the buyback done, and when do you think we could see you in the AT1 market? And then, finally, just a general question. Given political uncertainty that we're seeing in the UK and now that we're seeing in Hong Kong, as well as your management change, have you contemplated changing the way that you're approaching risk? Do you think you'll be pulling back on risk for the next six to 12 months, or how are you looking at that overall? Thank you.

Ewen Stevenson

Do you want to do the first two, Iain?

Iain MacKinnon

On the senior holdco, yes, just to repeat that we had anticipated issuing more, but for the reasons I gave we don't think that we need to do that this side of the end of the year. On the AT1, we have received confirmation from our lawyers and the SEC that we are able to issue AT1 even through the buyback period. We'd expect the buyback period to run to the middle of October, but I'd hope that if we are going to issue AT1, we'd do it well in advance of that.

Ewen Stevenson

On the political uncertainty and other uncertainty more generally and the economic outlook, we're constantly re-evaluating risk appetite. So, nothing dramatically new there, but we constantly re-evaluate risk appetite depending on what our view is on the outlook.

Robert Smalley

Just, if I could, one quickly on MREL. So, next year your maturities are much less, so would we look at a reduced MREL issuance number for 2020 as well?

Iain MacKinnon

Yes, I think that's right. We'll probably just roll over what we've got there and consider where we need to get to during the course of the year. We'll advise you probably a bit later, maybe later in Q3/Q4, what the outlook is, once we've done our plans.

Robert Smalley

That's great, thanks very much.

Ewen Stevenson

Thanks, Robert.

Lee Street, Citigroup

Hello, good afternoon. Three questions from me, please. First one for Ewen, I guess, just coming in and taking a fresh look at HSBC's balance sheet, I was just wondering how efficient you regard HSBC's capital stack, and what areas you can see to enhance its efficiency, if there are any?

Secondly, just on LIBOR, and as that ends, just how you think about the potential impact on bonds you have outstanding across the capital stack, and what options you have to deal with that?

And just finally, on page 24 of the fixed income slide deck, there's a reference to 'the future of UK regulation post-Brexit may impact our issuance plans'. Just wondering if you could give us some examples or thoughts on what you mean there? They would be my three questions, thank you.

Ewen Stevenson

Well, okay. On the first one, I think we've been very, very clear about what our balance sheet stack is. Look, I mean, my observation would be, having joined recently, that we're an incredibly complex group with a lot of capital complexity, capital inefficiency. We have a lot of non-diversified risk sitting in multiple subsidiaries across the planet. We have trapped capital sitting in various subsidiaries. We currently manage that through a high degree of double leverage at the group, which I think is appropriate, because it allows us to achieve that diversification benefit as a group that we can't achieve in the subs. But, yeah, overall, do I think that there's a significant opportunity for further capital optimisation? There is some, but I think some of it requires quite an extensive balance sheet consolidation exercise, which may take us multiple years to achieve. So I wouldn't assume there's any near-term significant upside on balance sheet optimisation.

Iain MacKinnon

I'll try and take LIBOR, though it is a bit of a $64 question. I think the main thing that I'm looking for when we're thinking about LIBOR is to have a settled programme that allows us to issue in a way that you would accept, and which everyone could understand how to hedge. And with that, we've been working internally, and consulting with a number of the other issuers in other banks, to see what the standard would be. Here what I'm talking about is the conventions around compounding, and the number of days of look-back. There's still a little bit of uncertainty around that, and we're not seeing much development in that, but I guess it will come eventually. Clearly, as we're moving forward, we're trying to do shorter-dated issuances, and it's more likely as we're issuing out of our UK bank, we'll do a SONIA issuance, particularly in the covered bond space, and also as a plain issuance. But we need to do some work on that, both internally on systems and on the way the market would accept that.

With regard to our MREL stack, most of that is – as you know, a substantial part of that is fixed rate, with a call option usually for the last year, linked to LIBOR. We would expect in most cases to call that, so I don't see that as being a big issue, but one of the things we do need to think about is the impact on future issuances, and we are looking at that.

Hopefully that helps.

Lee Street

Okay. And on the Brexit comment, on slide 24, please?

Iain MacKinnon

I think Greg can answer this, but it's probably just a caveat thrown in there by the lawyers, because who knows what Brexit looks like?

Greg Case

Hi, Lee; it's Greg. This is broadly just taking a view on the public statements that we've got from the Bank. So obviously the Bank doesn't necessarily like the existence of opco capital; we all know that. This is effectively us saying, 'Look, if the Bank doesn't like it and if we're leaving the EU and that doesn't bind the Bank of England's hands, they may choose to change the rules.' It is a statement you could apply to a lot of pieces in the slide deck, I guess, we just chose to put it there just to flag it.

Lee Street

Okay, that's alright. Thanks very much for all those comments.

Craig Robbins, NISA Investment Advisors

Yeah, thanks for taking the question. I just had a question around the Tier 2 that you highlighted that's no longer eligible for grandfathering. It appears just from the disclosure that you also made on your website and the size that you mentioned, that the majority of it is in the HSBC USA Inc entity. Can you give any colour around what's changed that drove that decision, as well as why that entity is not grandfathered, but it looks like HSBC Bank USA Tier 2 sub-debt is going to be grandfathered until 2025, most likely?

Iain MacKinnon

I think, if I can repeat the question, what you're addressing is that we've highlighted there's about $1.7 billion worth of US and Canadian issued debt, which we had classified as Tier 2, which, on further review, under CRR2 we're disqualifying. Is that what you're referring to?

Craig Robbins

Correct, and it does appear that the majority of that is at the HSBC USA Inc entity, the majority of that 1.7. And then –

Iain MacKinnon

We had a look at that, and we think that, following further advice under CRR2, a lot of it qualifies locally, but we're not confident it qualifies at the top of the house. So we're removing it from the stack. Maybe Greg can fill out some more of the detail there.

Greg Case

Yeah, sure. Obviously this is bonds moving, and as Iain said, it's specifically for the group consolidated. It's not at the local entity. And we're moving bonds from grandfathered into ineligible, obviously quite close to the grandfathering cut-off. So, we're only really talking about a couple of years here. And in a few places, obviously, these are bonds that haven't been useful to us for some time. So, for example, the old Household, now HSBC Finance bonds that we've LMed for before – those haven't necessarily been useful for us for some time. So it's something that we didn't pick up on when we were doing our review last year, because the bonds weren't in the scope of the review that we did. Now we've picked up on them as part of the review under CRR2.

Craig Robbins

Got you. And then just the entity that's below that, the HSBC USA Bank, it seems that those are considered eligible for grandfathering in 2025. I guess I'm just – I'm not clear on what's the difference between those two entities that in your view makes one eligible for the group, and then in another entity not eligible now.

Iain MacKinnon

It's to do – I think, on balance, it's to do with the fact that one is a regulated bank, and the other isn't, if that helps.

Craig Robbins

Got you. Yep, got you. Thank you.

Corinne Cunningham, Autonomous

Thank you very much. Sorry, I missed the very beginning of the call, so if you've already answered this tell me to go away, but hopefully I'm in time. Have you given anywhere what your double leverage ratio is? And I just wonder: is that starting to cause some ratings pressure, given that there's normally a limit as to how much double leverage you can have?

The other question I had was on the LCR. I just wonder if you can give us a bit more explanation as to what's happening there. And you also mentioned a new way of calculating it, so if you can just run us through there.

And then final one, which you may have already covered, was just the PRA view on non-qualifying debt; is it seen as an impediment to resolution after the rule changes or the rules outlined a week or so ago? Thank you.

Ewen Stevenson

Look, on double leverage we haven't put external targets out. We're comfortable with the double leverage we're running as a group. I think in response to one of the questions I was answering earlier, we've probably got the most complex balance sheet structure of any major banking group, and we don't have a single dominant balance sheet, and therefore we have a lot of non-diversified risk sitting in various subsidiaries across the planet. Therefore we do think it's appropriate that we can run higher degrees of double leverage at the group level in order to benefit from the diversification we have as a group, we triangulate that with our common equity tier 1 target and our results, the stress testing, and therefore we think 14% group target on common equity tier 1 is appropriate, which triangulates with comfort around the degree of double leverage that we're running. So I don't think we've ever said that we feel that we're under ratings pressure for double leverage. I think that was your comment, rather than ours.

Corinne Cunningham

And what is your double leverage calculation? What is the ratio?

Ewen Stevenson

We haven't published it, but you can come to your own views based on the disclosure we've got in the documents.

Greg Case

Yeah, Corrinne, you can see a large part of it on the holding company solo balance sheet that's in the annual report and accounts.

Corinne Cunningham

Yeah, we've had a look. Perhaps I'll run that through with you offline to see if you think our calculations are anywhere where they should be.

Greg Case

Happy to.

Corinne Cunningham

Thank you. And on the other ones? The LCR and the…?

Iain MacKinnon

Just to finish off on double leverage, we do pay close attention to this, and one of the reasons why we have…
On LCR, I think is the question I need to answer, what we have is a calculation where we're trying to aggregate or add up the LCRs across the group. The start point for the calculation is, oddly enough, we start with the European group and then that is used as the cap for the rest of the group. This time around, we removed some securities that were previously counted there, and we also saw downward management

of the non-ringfenced bank and the HSBC France risk appetite. And that led to the capping of the group LCR, which led to the reduction from 150-plus to 136. The reality is that we had no real change in the underlying liquidity of the group, as you can see from the analysis on page 14.

And the underlying liquidity, the HQLA is running close to $600 billion. The amount that we calculate to contribute towards the group number did fall, but the underlying HQLAs are still up there with the end-of-year figure.

Ewen Stevenson

Yeah. We also published the individual LCRs by legal entity; all of them are comfortably ahead of risk appetite.

Corinne Cunningham

Thank you. And then the last one was just a quick one on the PRA's view on non-qualifying debt.

Iain MacKinnon

Very little of that they view as subject to – being issued by the opcos, so we don't think that that's a big issue. Because most of the debt has been issued at the top of the house. That's fair, Greg, isn't it?

Greg Case

Yeah, this is something that's an ongoing piece of work across the debt stack and across the group as part of the resolution assessment framework that you mention, Corinne. We're doing that piece of work. We'll revert as and when we have anything to report, but at this stage all we're doing is looking at the bonds and applying the regs as we see them today. That more qualitative assessment will be done in time.

Corinne Cunningham

Okay, thank you.

Hadia Guergouri, Allianz Global Investors

Yes, hello everyone. I have two questions, please. First, in case of hard Brexit, what happens for credit impairment under IFRS 9, please? And my second question is on MREL. Is there some flexibility to manage down the sum of your requirements relating to group entities, please?

Ewen Stevenson

On the IFRS 9 question after hard Brexit, it will depend on what happens to forward economic guidance. We have set out in our interim report what we're currently assuming, what our central case is, what the three downside scenarios are. Under a hard Brexit we therefore would move to much more certainty, I think, on what the economic scenario looks like, and potentially won't have the skew to the downside, but we will move somewhere towards the downside. But until we understand what hard Brexit means and what the economic forecasting is as a result of that, it's difficult to provide you guidance. But we do think, based on the guidance that we've got in our interim report, there's a reasonable range of scenarios there with the provisioning against them, and you can apply your own probabilities and come up with your own views.

Iain MacKinnon

On MREL, we haven't yet got full clarity from the regulators, including the Bank of England, as to what our sum of the parts requirements are. We are in conversation with them about how that should be settled, and that will probably take place during the course of next year. Greg, do you want to comment any further on that?

Greg Case

No, I think just specifically on that, we've got to still figure out a few moving parts, particularly the interaction of the CET1 buffers across the group, when we're adding together the sum of the parts. And also, as Iain mentioned, we need to, particularly in Europe, understand how the European group consolidates, particularly with regard to Pillar 2. I think to address your question on how can we manage it, and how do we get flexibility, the rules are relatively set. So, I think we've just got to broadly live with it, and we'll manage it around the edges where we can.

Hadia Guergouri

Okay, thank you.

Jakub Lichwa, RBC

Hi there. A quick question on the reclassification of capital instruments. Can I ask, given the history, you guys classified last year the instruments, obviously, versus what you thought previously was the right classification. Now, obviously, the regulation has changed, you're reclassifying it again. Can I ask whether the current and the latest reclassification has already been confirmed with the Bank of England, with all the regulators, with the lawyers, or is this your latest interpretation and subject to change? Obviously this is also in the context of the discos and the waiver of set-off, which to my understanding can be interpreted a bit more differently. Thank you.

Iain MacKinnon

I'll take that. The exercise that we did this time round, we employed a law firm to look through 300 instruments external and internal with CRR2 in mind. We took the Bank of England through that. You can't say that we got a sign off from the Bank of England – that's not the way it works – but it's fair to say that they have paid some detailed attention to it. I can't really comment on the Akin Gump initiatives around the discos.

Jakub Lichwa

One more follow-up question: is there anything in your understanding that prevents you from moving some of the opco bonds to holdco, with regards to the bullet opco Tier 2s? Or launching a consent solicitation on the holdco bonds that have just been grandfathered until June 2025?

Greg Case

Obviously where we've got inefficient capital, where we've got bonds that are outstanding for longer than they are useful, we'll have to look at how we address that in the fullness of time. That can involve a number of things, and, as you mentioned, consent solicitation is something that we would look at. I think with the Holdings bonds, if they are US dollar SEC-registered bonds, the bar to get successful consent solicitation approved is very high. But that's not to say we wouldn't look at it, but these are all things we'll have to consider in the coming years.

Jakub Lichwa

Alright, thank you.

Ewen Stevenson

Thanks all for joining the call today. If you've got follow-up questions, please follow up with Greg Case through the normal investor relations debt channels. But thanks for taking the time to join, and appreciate your time today.

measures under GAAP are provided in the ‘reconciliations of non-GAAP financial measures’ supplement available at www.hsbc.com.