

Edited Transcript

Post-Interim Results 2016

Meeting with analysts hosted by Iain Mackay, Group Finance Director

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Corporate participants:

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Gavin Francis, Group Chief Accounting Officer
Jane Leach, Group Capital Controller

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Iain Mackay, Group Finance Director

It's been pointed out to me that I misspoke in response to a question on the call yesterday, where I referenced the common equity tier 1 (CET1) ratio for North America as being 24%. That's the total capital ratio for HSBC North America Holdings (HNAH), so the US businesses, not North America in the round. The HNAH total capital ratio is 24%, and the common equity tier 1 ratio is above 16%.

That is one clarification. The other clarification is, I notice in some of the feedback and commentary that's come through, is there is a question that by bringing the shares repurchased in the market into treasury stock, it's not really a buyback. So let's just put that record straight to start with: it is absolutely a buyback. Those shares sit in treasury stock. They are deducted from the equity resources of the Group, and they are deducted from the regulatory capital resources of the Group, and they support no dividend going forward, whatsoever. There are a number of alternatives. We could cancel the shares, or we could hold them in treasury stock. They have exactly the same effect in terms of capital treatment and accounting treatment. What holding them in treasury stock does do is provide some zero-cost future flexibility, with respect to their use. There's absolutely no stated intention, or any intention at this point, to put them to any use whatsoever, but with the view to maintaining as much flexibility as we possibly can, I think it's appropriate for the management team to always maintain flexibility around aspects of capital management as well as the wider management of the Group.

But to be absolutely clear, this is a real buyback, it is cancelled out of the equity resource of the Group, and it is cancelled out of the regulatory capital resource of the Group. In fact, the regulatory capital resource has already been impacted, because it was impacted on announcement, being yesterday. The actual equity will be cancelled out as and when the shares are repurchased, and we should be in the market today, with the start of that buyback programme.

So with those two points of clarification, I am very happy to take questions.

Stephen Andrews, Deutsche Bank

Just on the clarification, the 16%, thanks for that, because I was struggling with that number last night. It's just to work out the other side of the equation, the risk-weighted assets; are you are saying that the 16% is for HSBC North America Holdings, is that right?

Iain Mackay

Yes.

Stephen Andrews

Yes, so the only difference between the North American business and North America Holdings is Canada? So if we take out Canada –

Iain Mackay

HSBC North America Holdings does not include Canada. So in HSBC North America Holdings is the Finance Company, the broker-dealer in the US, and the Bank in the US.

Stephen Andrews

Absolutely, because we know the capital for two of those three. We know the capital and risk-weighted assets for Canada. My question is, as Canada is not included, if we look at the \$215-216 billion of RWAs you disclose for North America, if we just take Canada out of that are we okay then to say that is...?

Iain Mackay

Yes.

Stephen Andrews

Or is there some sort of...?



Iain Mackay

No, that's it.

Stephen Andrews

Okay, so we can work out –

Iain Mackay

Yes. Absolutely.

Gurpreet Singh Sahi, Goldman Sachs

Question regarding the buyback and then where the capital position is, how comfortable you are with the difference to your subsidiary, Hang Seng Bank which is keeping 16.8% and presuming Hong Kong comes out of Basel IV, IFRS 9 or anything else. The economic scenario for Hong Kong is not that negative, compared to the global macroeconomic scenario. So keeping 16.8%, because they did what they did last year – they gave a special dividend on the back of the disposition of Industrial Bank. How should we read into your 12.8%?

Iain Mackay

The capital requirements in each jurisdiction around the world are informed by local regulation, and just as The Hongkong and Shanghai Banking Corporation Limited (HBAP) is subject to regulation from HKMA, which informs our capital ratios here; so is Hang Seng. That's what informs our capital ratios around the world. And if you look across the peer group, at the population of banks in Hong Kong, you'll generally see them sitting with higher capital ratios than you'd experience in the US, the UK, most of continental Europe, Latin America – well, Latin America actually is similar in some respects, but that's informed by the local regulation.

Dominic Chan, BNP Paribas Securities

I've been asked by a couple of clients today as to the impact of the minimum capital requirements, when you move from Basel III to Basel IV. When you make the move, the minimum requirements will actually increase which actually doesn't allow you to do further share buybacks, special dividend or even maintain the current ordinary dividend. What do you think of that?

Iain Mackay

So, toeing the line on behalf of the Bank of England, there isn't a Basel IV, right? There are refinements to Basel III, and the nature of those refinements, although we've got an outline of the nature of those refinements and we've obviously all done quantitative impact studies that tell us that, if the consultation document were transposed into law, regulation, then the impact would be very, very significant for the industry across credit risk, operational risk and, depending on how you implement, probably much less significant with respect to market risk. However, what we also heard is we've heard governors and heads of supervision through the G20 saying that this is not about significantly increasing the capital requirements for the industry. And so, until we get clarity as to what that means, hopefully later this year or early next year, we don't know.

But what you do hear, resoundingly, from the governors and heads of supervision, and you heard this in the G20 meeting just last month in China, is this is not about significantly increasing capital requirements. What none of us know is how that gets recalibrated, because presently it would mean very significant increases in capital requirements. So, you know, again through engagement with the Bank of England, European supervisors, as recently as this morning regulators in Hong Kong, they're all meeting several times through the Basel Committee, between now and the end of the year, to address the calibration issue. How that turns out, nobody knows.

Dominic Chan

Okay. My second question is on the treasury stock. Are you going to retire this or are you going to sell it?



Iain Mackay

We're going to do nothing with it. It provides a zero-cost optionality around the future use of that stock. We have no intentions with it just now. We can cancel it, or it can sit in treasury stock, where it has an accounting implication, which makes life a little bit more complicated for Gavin (Francis) and the team. But no, there are no intentions with respect to this.

Katherine Lei, JP Morgan

I have two questions. The first is, too, on the treasury stock. I just want to understand, under the current regulations or the listing rules in Hong Kong and London, are you allowed to sell the treasury stock – are you allowed to trade on the treasury stock, basically?

Iain Mackay

No.

Katherine Lei

No, right. Okay. So this is one. The second thing is, I understand there's a lot of uncertainty in terms of the capital regulations, but there are a few things that we already know. First is that it's likely on the revenue side, there will be more volatility, likely on the bank side, and then also that we're going to have a countercyclical buffer. We don't know how much the BoE is going to impose it, but it is coming out.

Iain Mackay

No, we do know. They've cancelled it.

Katherine Lei

They cancelled? Oh.

Iain Mackay

So there was a policy statement last month from the Bank of England, saying that the countercyclical buffer, which was to be 50 basis points starting in March of last year, is now zero. So that has been removed.

Well, the countercyclical movements will always be temporary in nature, because it's there to be moved up and down based on how the economic and prudential cycle is developing.

Katherine Lei

I understand, but with Brexit, would that be different? Because the whole environment is going to be different.

Iain Mackay

Don't know. There's a great deal of uncertainty as to what Brexit means for both the UK and Europe. You know, we're five weeks after the referendum. There's quite a lot of stuff that the policy-setters, the regulators, the industry, the economy as a whole needs to work through here. It's uncertain.

Katherine Lei

Sure. So that links to the last part of the question on the implications on dividends, because, if we keep the 51 cents, actually that would mean that, potentially, the payout ratio could be over 100%.

Iain Mackay

In 2016 and 2017, we expect the ratio to be – in 2016, it will definitively be over 100%. We know that. And in 2017, again it obviously depends on what happens in earnings, but because of some of the restructuring costs that we've got coming through, some of the capital actions we're working on, we would expect the payout ratio to be very high next year, as well.



Katherine Lei

Do you think that – or do you foresee that there is potential that the regulators are going to step into it and say, ‘Hey, in an environment like this, you have to be careful with the payout ratio being too aggressive’?

Iain Mackay

If there were economic elements or developments that significantly adversely impacted the earnings for the industry, well, one, the regulator wouldn’t need to, because we manage our dividend policy based on the capital strength of the Group and what we see in terms of the earnings capacity of the Group, cash position, the distributable reserves position, etc. So if we saw an environment that so adversely impacted the earnings of the Group in a particular year that you simply had a forward view as well that didn’t look at something that was reasonably encouraging in terms of recovery, then frankly we wouldn’t need the regulator to step in. We would take the appropriate capital management actions in those regards.

But obviously, based on our comments yesterday, and the fact that the PRA approved a buyback of \$2.5 billion would hopefully speak something about the management team’s confidence about where we are from a capital perspective, management’s confidence about the ability to sustain an appropriate level of profits to support the dividend that we’ve talked about. That’s why we said what we said yesterday.

Steven Chan, Haitong International

Today, if you read the media reports, I think Stuart yesterday told the reporters that next year, probably, you’re going to do another round of share buybacks, because of these repatriation of dividends from US. And he mentioned that the amount would be similar to the share buyback this year, which is around \$2.5 billion. So I just want to clarify whether it is true or not, and if it is true does that imply that you think that next year the CET1 ratio is going to be again well above 12.5%, or the amount of dividend you are going to receive from the US is well above \$2.5 billion, so you’re going to pay \$2.5 billion?

The second question is again about the treasury stock. Can you clarify whether you can use the treasury stock for scrip dividends, or for your –

Iain Mackay

Perhaps I can give you an example of what we could use treasury stock for. We could use treasury stock for employee compensation plan, but that is not our intention. Our intention would be to meet employee compensation plans out of open-market purchases, on market purchases. But if you think about it, when you look at the size of our compensation plans versus the size of the buyback we announced yesterday, it’s about five years’ worth of compensation. But that’s not our intention. Our intention is to satisfy employee compensation, which is the variable cost – the variable compensation component is, above a relatively low threshold in terms of award, it’s awarded very, very substantially in stock, which is then deferred for anywhere between three to seven years. But that is not our intention with respect to the treasury stock, but that is one use that treasury stock could be put to.

Going to your earlier question, getting a no objection to our capital plan through CCAR, we passed CCAR a couple of years in a row now, so it’s a clear indication that the Fed is gaining greater confidence in our capital management processes and capabilities within the US business. It is hopefully some reflection of the continued restructuring that is being done in the US. There’s more that clearly needs to be done, and Stuart spoke about that yesterday. It is confidence, hopefully, in the capital position of the US, which is particularly strong.

So the way that the CCAR works is there are two capital planning windows: the first four quarters, which is the year in consideration, and then the next five quarters. So CCAR covers nine quarters. This year, we’ve put the dividend in the first half of 2017. That’s what received no objection from the Federal Reserve. So next year, that dividend will be put in the first four quarters, because you move the window forward. That goes in the first four quarters, which would suggest a dividend paid in the first half of next year. That – provided that ‘no objection’ stays in place, and there’s no reason it shouldn’t stay in place – would then be what would support a dividend from the US to the holding company. We have proposed a substantial dividend. I’m not going to give you the number, but it’s a big dividend.

Steven Chan

But as one of the UK analysts asked the same question, is that that will not affect the consolidated CET1 ratio. The fact that you're going to pay certain amount of share buyback next year, that means that you're quite confident to next year's CET1 ratio.

Iain Mackay

We wouldn't be doing a buyback this year if we weren't confident about next year's common equity tier 1 ratio and the capital adequacy ratios. Post-Brazil and post this buyback, we'll have a common equity tier 1 of 12.6% fully loaded. We generated 20 basis points of capital in the second quarter of the year, from profit generation and continued management of capital through RWA reduction, amongst other things. It's our goal to continue to accrete capital from the operations on a day-to-day basis. That's what we do – that's what we aim to do every day we open up for business in the Group. We are sitting above the middle of that range on a pro-forma basis. It's not even pro-forma. The Brazilian transaction's closed. We're in the third quarter, at above 12.5%, and we said we were going to operate in the 12-13% window, with a preference to be above 12.5%. We're there. So we have confidence in where we sit from a capital perspective. I think it is a reasonable assumption that the PRA would not have approved this buyback if they didn't have reasonable confidence in our capital build as well.

Steven Chan

Okay. And finally, a separate question is, will Hang Seng Bank also apply the same dividend policy of HSBC?

Iain Mackay

Hang Seng is an independent company. They've got an independent Board, of which Sarah (Legg) is a member. The dividend policy for Hang Seng is set by the Hang Seng Board, right? But, as you'll also notice, Hang Seng's dividend practice has been very consistent over recent years.

Alastair Ryan, Bank of America Merrill Lynch

It's a balance sheet question for me. GB&M assets up quite a lot in the first half. Just like to go through that a little, whether you got bored of being disciplined or you stopped watching them, and they've grown assets rapidly, as investment banks always do, or whether it's just technical because rates moved around, or whether there's – because you've got a strong leverage ratio, you're not that bothered about that number, so you're allowing a bit of headroom for them to generate some more revenues?

Iain Mackay

Yeah, the increase in the position in Global Banking and Markets is as you would imagine, all coming through trading assets and trading derivative assets and liabilities, in support of those trading activities. There's a bit of Global Banking and Markets lending coming in, which is just growth in terms of credit support to major customers. It's certainly not any indication of slacking off in the discipline around the capital management within the Global Banking and Markets business.

So our target of having a reasonably consistent 30/30/30 split across Global Banking and Markets, Commercial Banking, Retail Banking and Wealth Management remains consistent. We obviously, as you can tell, still have a little bit of work to do in that regard. Now, we're not going to be overly prescriptive around 30%. We can live within some kind of tolerance of a few percentage points either side of that. But the step up in the balance sheet overall is largely through derivative assets and liabilities and trading assets and liabilities, which was really just a function of flow and activity through Rates, Credit, Foreign Exchange in the second quarter.

Alastair Ryan

Can I just push you a bit on that, though? It's \$260 billion, which is bigger than most banks, is the first half increment. And if I look at total assets, and GB&M is 70% of the Group at the first half, at least pre-intersegment elimination. So the return on assets in that business is particularly low. Just to ask how you're thinking about allocating capital, because if you're just looking through a risk-weighted asset lens, that'll tend to keep happening until you tell them they can't do it anymore, because activity wasn't that strong in the first half, and \$260 billion is a lot. If it's just on the stock of derivative positions getting

marked to market, I would understand. But if it's flow business, that's kind of an active decision you're taking to take share.

Iain Mackay

We've got about \$180 billion between Balance Sheet Management, Global Banking and Markets trading assets and derivative asset increases, really all of which is informed by short-term trading activities. There's a slight step up in settlement accounts, but again that's largely informed by the trading activity with bank and non-bank financial institutions. There's not per se a specific goal out there as to the specific asset balances we have within the Global Banking and Markets or any other business, at any given point in time, but the capital is deployed with a focus, obviously, on the return on risk-weighted assets, and more broadly a return on the tangible equity that that business can generate.

But, by the same token, we've got a very substantial corporate surplus that we sit on, principally within our Asian businesses, but also within Europe and the United States, and when the market opportunity exists to deploy that profitably, then the Balance Sheet Management team have the authorisation to do that, and it's deployed through the Global Markets business. So the biggest funder to the Global Markets business tends to be Balance Sheet Management, and Balance Sheet Management gathers the surplus deposits from Retail Banking and Wealth Management, Commercial Banking and Global Banking in. So, to ramp the balance sheet in Global Banking and Markets is not a goal, but to deploy the liquidity that we've got profitably when the short-term cycle opportunity presents itself to do so, then absolutely.

We have an operational metric around return on risk-weighted assets, and increasingly – there's always been an economic capital view within Global Banking and Markets and increasingly we're challenging Global Banking and Markets and the other businesses to think about a range of return metrics that it's not just a regulatory lens but an economic capital lens and an accounting lens, to look at the return opportunity within the businesses.

Tom Rayner, Exane BNP Paribas

At the last breakfast meeting after Q1, I think you were asked whether you would consider reducing your capital ratio targets because Basel IV wasn't going to happen, which you said was a nice idea but divorced from reality. It doesn't sound like you've changed your mind, because you're not talking about changing your targets today. But the thing that interests me is the fact that we don't yet know about Basel IV – as you and Stuart both said yesterday, there's 1.3% Pillar 2A – I think you said probably absorb 5% or 6% RWA inflation by bringing that down, but there has to be still a chance, I think, that RWA inflation from Basel IV is going to exceed that, and we've also got IFRS 9. We don't know the UK stress test results. You've said yourself, Brexit is hugely uncertain. Just wondering why did you decide to start the buyback now, given all of those uncertainties? Why didn't you just wait and maybe think about that as something for next year?

Iain Mackay

So, the buyback is very specifically linked to the disposition of our Brazilian operations. That has freed up more than \$5 billion of capital resources. Those are capital resources that both we, and, it would seem, the PRA, don't believe that we need at this point in time. We obviously didn't do a \$5 billion buyback; we did a \$2.5 billion buyback – or are doing, rather. And so we still, I think, demonstrated a suitable degree of conservatism in our approach to capital management in this regard.

Yes, there is clearly uncertainty out there. The Brexit uncertainty – I think your community has perhaps observed this quite clearly - on the back of the vote five weeks ago, HSBC's was one of the few shares that traded positively on that news. It's an interesting observation, but I think it's an entirely appropriate observation that HSBC does work in more countries than the United Kingdom; it is diversified by global business; it is diversified by geography. It has a strength and a resilience from a balance sheet and capital generation perspective in which we are confident, and that's why we started the buyback. The buyback is linked to the disposition of our Brazilian operations, and to sit with a higher capital ratio than is necessary would seem not a particularly good or efficient use of our shareholders' capital.

Raul Sinha, JP Morgan

One of your peers in the UK has given a commitment that 13% is the right core tier 1 for them, and if they report a capital ratio above that, they will use that to return – you know, they'll use the surplus above 13% to return to shareholders. From whatever you've said since yesterday, it seems to me that your message is, 'We sold Brazil, and we've generated cash, and we're linking the buyback to the excess cash.' Clearly you're very confident about the capital and the outlook. And next year's buyback, if there is one, is potentially because you sold the cards business in the US and the upstate New York branches, and that capital was tied up, so effectively linked to disposals, rather than linked to a common equity tier 1 threshold. Is that the right way of reading it – that you might still report a 13% core tier 1 ratio, going forward; we shouldn't think that every time you get to 12.8% you're going to buy back?

Iain Mackay

I think that's the right way to think about it. Our intention is to manage the Group to a common equity tier 1 ratio of between 12% and 13% – I think Stuart said yesterday, more probably between 12.5% and 13%. Sitting at the top end of that range would not be troubling to us in the slightest. Again, it would certainly inform capital stability and strength. And so future buybacks, to the extent there are any, will be linked to capital transactions that we have either undertaken or will undertake.

And, I would add where those transactions have resulted in us being able to get the capital and the cash sitting in the holding company in the UK. But the way the Group works from a cash flow perspective, supporting investment and dividends, is the subsidiaries generate profits and they pay dividends to holding company, when they meet and exceed local regulatory requirements. Where they cannot dividend to us, then the cash is not available in the holding company to pay that on to shareholders.

Raul Sinha

Can we have some disclosure on that going forward, given it's so important to the share plan?

Iain Mackay

In terms of?

Raul Sinha

The cash surplus that you currently have.

Iain Mackay

Yes, we always carry a capital buffer in cash or near cash instruments at the Group level of \$10 billion or more, always. That is part of the risk appetite of the Group, always.

Raul Sinha

That's very useful. Thanks. Just a second one on impairment so we can finally move on, obviously Brazil looks like it had a 7.8% impairment ratio in the first half of the year. If I take that out of the P&L, the impairment charge you're currently operating with looks to be around the 37 basis point level annualised. So if my math is correct, I just wanted to draw you on what you think happens in the current environment to that impairment charge. You made some very clear comments about metals and mining, oil and gas and the pressures there. Is there anything more? Do you think that 37 is the right number in the current environment that the market should think about or is there some pressures that you think still could move it higher?

Iain Mackay

So credit quality – you're right. Your calculation is, according to us, one basis point out. We think it's 36 basis points, but you're right. Our line of sight on credit quality presently is very much informed by oil and gas, metals and mining and Brazil. Brazil obviously is somebody else's concern now. I think, when you reflect on the Brazilian activity, it's informed by one deteriorating economic environment: Brazil. But, also, it's indicative of when a bank is being sold, funnily enough, you get customers that decide it's time to stop paying that back. That obviously, in terms of a closing balance sheet, is trued-up in the purchase price that Bradesco has paid for the organisation. So I think we probably saw a little bit of a disposition effect

within our loan impairment charges in Brazil. But the main driver here was economics in that country. Somebody else's portfolio to manage now. But the rest of it is about metals and mining and oil and gas, so when we look at the UK portfolio outside oil and gas – very stable. I gave you some details on the call yesterday about the mortgage portfolio, for example, which we can go into more detail if you wish. Commercial real estate – very, very stable; well collateralised. The wider commercial and industrial portfolio is in the UK performing well. We're not seeing it come through the middle market in Commercial Banking or Global Banking at this point in time. Mainland China credit, Hong Kong credit, Aussie credit outside metals and mining, oil and gas, same in Indonesia. Outside oil and gas, metals and mining, very, very stable across the Group. Everything that we're seeing right now, and monitoring credit ratings and migration across the portfolio, we're not seeing emerging issues beyond the particular sectors we've drawn out.

Andrew Coombs, Citi

Following on from the previous query, I fully appreciate that with the Brazil sale you get a capital benefit and you're paying back half of that through the buyback. You've linked the buyback next year – or potential buyback next year – to the upstreaming of the dividend from the US entity. As we said, that's a cash move as opposed to a capital change on consolidated accounts. When we look at your cash reserves at the HoldCo, they already look very healthy. I might be looking at the wrong number, but I thought you had cash reserves just shy of \$50 billion.

Iain Mackay

There's a distinction between capital – this is a liquid capital buffer. We've got more cash than you can shake a stick at. We've got a lot of cash. But we look at liquid capital buffer, we look at capital ratios, we look at double leverage ratios – all of these things inform what we do from a capital actions perspective. The capital buffer that we maintain, of \$10 billion at the holding company, is there specifically for prudential reasons. It's part of the risk appetite for the Group, and we would not use that – at the \$10 billion threshold or below – to do dividends, to do buybacks or any such thing. So any time we pay out of that, we replenish it, and we replenish it from the dividends that come from our operating subsidiaries.

Andrew Coombs

So you're saying at the HoldCo entity, you look to maintain a \$10 billion buffer. You feel you are at or around that level currently. The US upstream will therefore replenish that and you can – effectively, that is now your binding constraint as opposed to any capital regime.

Iain Mackay

It's not binding constraint. It is a prudent capital management action within the firm. It's not a binding constraint. From a risk appetite perspective, we would not want to come below that. And I think, frankly, a regulator would prefer that we maintain that liquid capital at an appropriate level. The binding constraint for the Group is, in most of our entities around the world, is common equity tier 1 requirements.

Stephen Andrews, Deutsche Bank

Can I come back to the US, because it's quite a big deal: first time in 10 years you can dividend cash out. Can I ask about the future of HSBC Finance because you've gone from \$160 billion of assets to \$20 billion.

Iain Mackay

It's really easy.

Stephen Andrews

My question is when.

Iain Mackay

Sooner the better. You see where we are now? So when we closed the end of year, I think we were on about \$17 billion of unpaid principal balances. We're now at nearly \$11 billion. So we've disposed in the

first half \$4.7 billion. In July, we disposed of another almost \$1 billion. In the second half of the year, we will almost certainly do more. So the team is on – and have been now for quite some time, they are on the track of getting this thing to zero as quickly as sensible economic transactions enable them to do so.

Stephen Andrews

Can I ask the mechanics of this, because what happens to HSBC Finance? Does it get folded or closed, because it's still \$4.8 billion of capital there; \$2 billion of that is deferred tax, absolutely appreciate that. That then goes to HoldCo and then out.

Iain Mackay

So the US is very similar to the UK. There's a tax consolidation, right? So the deferred tax asset would then be evaluated against the profitability of the wider tax group in the United States. But the intention in – and this will take, just to delist HSBC Finance Corporation (HBIO), which is an SEC registrant – we've got about 120 entities US-wide because sub-prime lending, mortgage-lending tends to be a state by state regulated affair – at least it was when we bought Household. So we've got about 120 entities to close down. Whilst we have a single loan in any of those entities, you can't close them. So the progressive effort is get the book down; as we get the book down to zero on each of those legal entities, we close down those legal entities and, progressively, we will move towards deregistering HBIO as a legal entity. So it will literally cease to exist. The capital resources, as that book is wound down, then becomes available to the Group. It is obviously part of the consolidated capital ratios of the Group in the US and that becomes surplus to requirements, some of which we may deploy back into our banking business, but we do sit on a reasonably substantial amount of capital surplus to requirements from a US perspective. And, given the shape and nature of the business, and the risk appetite in the US, the likelihood of deploying the capital that becomes released from that wind-down entirely into the bank is improbable.

Stephen Andrews

Just my question is, for the last two years, we've been giving you a hard time about \$30 billion of capital in the US making no return. You've sort of popped the cork off the top of the bottle now. You're focusing on the cash at the holding company, but there's a lot of other capital there that is questionable. I know you've got to be in the US, you've got to have a business there, but it's questionable whether that needs to be \$30 billion of capital beyond the \$4 or \$5 billion. If we look at the bank, there's \$20 billion of capital there. A lot of that capital is with a GBM balance sheet that, again, doesn't seem to be making much return. Should we be thinking about, okay, now that this CCAR ruling has happened, that, actually, this is what will improve the returns in the US business? It allows you to upstream much, much more capital than the \$4 or \$5 billion over a two, three, four-year period?

Iain Mackay

It does, but remember CCAR is an annual process. There is not a bank in the US that gets to pay a dividend or do a buy back unless it's approved through CCAR. Does not happen. It is an annual process and you are reassessed every year. So we have got to make sure there are processes and the strength and resilience of the business continues to improve so that we keep the Fed very happy with what we're doing, which would then absolutely enable us to upstream capital surplus to requirements, either through something specifically linked to previous transactions around, for example, the distribution of the cards or the upstate branches or the rundown of the wider CML portfolio, to allow to upstream it. It would also allow us to continue the restructuring that we're doing in the US business, which focuses on Global Banking and Markets balance sheet globally – but the US is clearly part of that Global Banking and Markets business – the Commercial Banking business and the Retail Bank. So it is part of the wider restructuring of the US. As Stuart said in the call yesterday, there's still a lot to be done in the US and some of the things you refer to exactly – you know, they fit squarely into that bucket.

Stephen Andrews

You could say you were running the US bank with a fat balance sheet because you couldn't get the capital out anyway.

Iain Mackay

Absolutely. This is the first time since 2007 that we've got the possibility next year of getting capital out of the US. If you took our capital ratios in the US and compared them to anybody in the top 10 holding companies, I mean, our capital ratios are twice what they have.

David Lock, Deutsche Bank

Just staying with capital, but shifting to another subsidiary, HSBC Bank plc, the core tier 1 ratio looks like it's actually just below 10% at the interim. I just wondered, what's your planning assumption of what that core tier 1 ratio needs to be for the Bank plc going forward? And I had a second one, which is on the scrip: I just wondered if you could update on whether you've changed any planning assumptions because I know that the scrip take-up was very low – about 10% in the first quarter on the fourth quarter dividend. Thank you.

Iain Mackay

UK Bank PLC largely informed by regulation around ring-fencing. So the ring-fenced bank – and I think the Bank of England/PRA has been fairly clear about what the future capital requirements would be, probably around, again, the 12-13% mark, so entirely consistent with the Group's consolidated common equity tier 1 ratios. That is going to be some degree informed by where the UK bank of HSBC would fall from a domestic systemic importance perspective. So, at the moment, we think the D-SIFI buffer is probably going to have us – because we're quite small compared to our UK peers from a ring-fenced banking perspective. So we're probably going to fall in that 1% bucket, so obviously there's no impact from the Group because our Group were carrying a G-SIB buffer of 2.5. So it sort of informs more the common equity tier 1 ratio for the UK bank ring-fenced on a sole basis post-ring-fencing. On the non-ring-fenced bank, it's going to be informed again by UK regulation, but also I think, generally speaking, it would be informed by Group capital ratios. So, again, our planning scenario is sort of around the same 12-13% range for both the ring-fenced and the non-ring-fenced bank.

I think when you look at go forward design, the non-ring-fenced bank is more probably likely to be bound by the leverage ratio as opposed to common equity tier 1 ratios as possibly the binding constraint. And I don't think that would be inconsistent. When you look at Global Banking and Markets businesses, which is basically what the non-ring-fenced bank will be as we presently propose it in the design, again, it is often the case that the leverage ratio is the binding constraint, as opposed to common equity tier 1.

On scrip, the scrip take-up is entirely informed by where the stock price sits versus the option – the strike price – when it's declared. In a quarter where the stock price is below, there's big take-up; when it's above, there's small take-up. And that's what informed the about 8.9% take-up in the first quarter on the fourth interim dividend. In terms of scrip, no change at this point in time. I think I've mentioned in the past the scrip is viewed as an important instrument for a significant portion of our Hong Kong retail investor base. It is certainly something that the regulators look upon quite favourably. We continue to explore ideas whether, for example, it could be converted to a dividend reinvestment programme as an idea. But that's what it is at the moment; it's an idea as opposed to a policy. So right now, no change on the scrip.

David Lock

Just as a follow up to the HSBC Bank PLC question, I assume, barring any Brexit disaster for the UK business, your assumption is that that will generate its own capital over time to fill that 12-13% requirement, or do you think you're going to have to downstream any capital?

Iain Mackay

It will depend – your planning assumption is one we are using, which is it will generate, as it does – that ring-fenced bank... If you look at the ring-fenced bank, which is Retail, Commercial and Private Bank, it's going to have returns in the mid-teens on a fully loaded basis from a planning perspective. So, absolutely, it's a capital-generative, capital-accretive business, with a strong propensity to pay dividends to the parent in the normal course of operations. So accreting up to that point is our planning assumption. It is not entirely impossible that the PRA may want us to get the Bank PLC there faster, in which case we may have to downstream capital. But, again, going back to the consolidated ratios of the Group, it's just where the capital sits.



Daniel Lasry, Bernstein

In Hong Kong we saw credit growth in Commercial Banking and GB&M, but Retail was, again, flat. Is this a risk asset type restriction or are you seeing this more demand driven?

Iain Mackay

Demand driven. Hong Kong flat, as you say. Reasonably constructive from a Commercial Banking perspective, but flat to down in Global Banking and Markets and flat in Retail Bank, and that has been demand driven. If you look at the first quarter, in the month of February this year, it was the lowest level of mortgage applications in Hong Kong since SARS. Now, since that time there's been recovery coming through March, April, May and June, and we're seeing much more normal – normal, as in historically normal, as opposed to normal versus last year or the year before levels – and certainly much more cautious consumer sentiment in Hong Kong and that is the best indicator of the fact that you saw volumes down in terms of equities on the Hong Kong exchange in the second quarter, 62% down. It's that factor which largely informs part of the revenue equation in Hong Kong in the second quarter for HSBC. But the phenomenon in Hong Kong has been demand driven. Now, we're beginning to see that stabilise and confidence beginning to creep back in, but we still remain fairly cautious in terms of second half outlook.

Daniel Lasry

And on the Private Bank, we saw assets under management coming down again and we see peers in Private Banking really going aggressively to grow their AUMs. Can you give us some more colour in terms of geography and where it's coming from?

Iain Mackay

Good net new money coming through the UK. Our UK business, our European business grew net new money to the tune of about \$5 billion – I think \$4.5 billion-\$5 billion – in the first half. In Asia and pretty much everywhere else in the world, we saw net either flat or, in some cases, outflows where we saw very high net worth customers in certain geographies going to, frankly, a cash position. I think that's a bit of a cyclical view of the world as opposed to anything structural.

That being said, there's also a structural effect within the Private Bank more broadly, as Peter Boyles and the team have done very extensive reshaping of that business over the last five years. We've disposed of portfolios, we've exited literally thousands of customers with respect to risk appetite and with respect to tax transparency. Where customers have been unwilling to be completely transparent in their tax affairs, we have quite pointedly exited them from the Private Banking portfolios. That reshaping of the Private Bank is largely complete. It's not done and dusted, but it's largely complete now. And that reshaping, particularly within Europe, is what has informed an impairment of \$800 million of goodwill coming through the second quarter. But no, the European business saw net new money growth. Asia, the Americas – flat.

Martin Leitgeb, Goldman Sachs

Could you shed a bit of light on how Household is being considered or treated as part of the CCAR process and at which point in time would Household no longer be considered for the US CCAR going forward? And the second question on your RWA reduction programme: you state you're 60% through. Could you shed a bit of light of what is left to do there and whether that will be completed as planned by the end of 2017? Thank you.

Iain Mackay

Okay, the second one is really easy, Martin. 40%, and yes. Slightly less than 40% actually, because we're a bit more than 60% through, but it's the usual suspect of Global Banking and Markets, it's Commercial Banking, there's a little bit in Retail Banking and Wealth Management, there's the continued rundown of the CML portfolio in the US, which is a nice segue into the discussion of household.

Until Household is gone, it will be part of CCAR as far as I'm aware. There is no de minimis measure, as far as I'm aware, around the inclusion of business and exposures within the CCAR process. So until it is

done and dusted and gone, HSBC Finance will be part of the CCAR process. And it is part of what they stress, so there is a slightly odd approach to CCAR in the US but they do take the sub-prime portfolio and you can absolutely see why this would be informed, but it does experience very significant stress. Now, obviously, the smaller it becomes, the less stress it causes to the capital ratios of the holding company, but it will be part of the game until it's done.

Chintan Joshi, Independent Analyst

Can I check on litigation? You took a top-up in the quarter. What was it related to and any update in Libor, FX, mortgage backed securities, any progress on any of those big ticket items?

Iain Mackay

It's all in Note 19 to the financials. To say that our legal counsel is exhaustive in his disclosure of material risks through Note 19 would be an understatement. Stuart Levey works very closely with Gavin Francis and the team and myself in terms of what's disclosed in there. Obviously, very happy to get Jaffe behind us. So that's the single largest litigation that we had out there that we could quantify and that's behind us now. To the extent there are developments, it's in Note 19, but there's nothing in terms of material progress either in Libor, foreign exchange, Madoff, Euribor.

Chintan Joshi

And then, going on to Asia, was there a change in activity levels in Tokyo compared to 1Q or even how you're seeing second half develop outside of GBM, so I am talking more about traditional banking? Have things eased off compared to 4Q and 1Q?

Iain Mackay

Commercial Banking, as you saw, chugged along reasonably nicely. The UK progressed well. It's perhaps counterintuitive but our Commercial Banking business saw loan growth and revenue growth coming through in the United Kingdom. It did well – our businesses did quite well in Mexico. It's still small in terms of where it needs to be for profitability and returns, but both in Retail Bank and Commercial Banking, our Mexican business is getting traction and progressing in the right direction. In the US, Commercial Banking had reasonably good traction and, as Stuart pointed out yesterday, the Retail Bank is in a breakeven position in the US now, which represents progress. It all sounds a little bit sad, but it does represent progress, which is good.

In Asia, I think it's flat. We certainly saw better levels of activity in the second quarter versus the first – I mean notably better levels of activity. But when you look at it compared to the same period last year, which was going dam busters in the second quarter last year in Asia, it's obviously down. But clear progress against the first quarter, in each of Global Banking and Markets, Commercial Bank and Retail Bank, but still some way behind where we were in the second quarter of last year.

It's not all doom and gloom. We're seeing development in the Pearl River Delta and, as we said yesterday, Peter Wong and the team are very much pacing their investment. Customer numbers are up in the Retail Bank, customers are up in the Commercial Bank in Pearl River Delta. We're continuing to progress – hopefully getting approval for our majority-owned Joint Venture on the brokerage front in Guangdong province, so we're hopeful and optimistic about getting approval for that in the second half of the year. That'll be a good step in the right direction. Indonesia coming along reasonably well. Actually, the ASEAN countries – so exclude Hong Kong and mainland China – saw reasonably positive levels of activity both in terms of net interest income, non-fund income, trading income and profit before tax development, with a very stable credit portfolio, again, outside oil and gas and metals and mining. God knows it's not boom time, but in those markets where we're seeing growth, we're seeing 1-2% growth and it's most noted within Commercial Banking and in some markets in Retail Banking.

Chintan Joshi

How much of the run-off portfolio sits in the US, excluding CML?

Iain Mackay

A very small proportion. The total legacy risk-weighted assets in Global Banking and Markets is now about \$18 billion, I think it is – \$18 or \$20 billion. And about 25% of that, I think, is in the US. We'll check that and validate it for you, but I think about 25% of that is US based.

Manus Costello, Autonomous

Can I just come back on David's question about HSBC Bank plc because I'm struggling to fully understand the capital allocation round the Group because if I piece together what you've told us today, you're saying there's no intent – you're towards the bottom end of the area you want to be on core tier 1 ratio on a consolidated basis, 12.6%, and you said 12.5-13%. You're telling us that you have an overcapitalised subsidiary in the US which will be able to remit capital, but you're telling us that you have an undercapitalised subsidiary in the UK, which may need capital downstreamed. So I'm confused as to how you can take that surplus in the US, pulling it back holdco, pay it out and then potentially have to downstream capital to Bank plc. I can't quite square that circle.

Iain Mackay

So perhaps the confusing part may be that we generate capital as a group day after day and we allocate capital to the businesses that can generate those profits. The UK business generates capital and the expectation is that the UK business will self-capitalise. If the regulator requires us to get to a different capital ratio sooner than that self-capitalisation would develop over the next two to three years, then we may take some of our capital resources and downstream it. But we're capable of doing that within our capital resources that exist today.

Manus Costello

So, in that case, you are funding the buyback therefore out of the capital generation as a group going forward, rather than simply from an asset sale historically.

Iain Mackay

Capital's fungible, right? So if I funded from profit generation, that's surely a good thing. If I funded from disposed assets, that's probably a good thing. The fact that we have capital strength – and by the way the range is 12-13% and we're above the midpoint of that range – if we have that capital strength and have a line of sight to the continued sustainability of the dividend with the profits generated by the Group, the propensity to take surplus capital and then hopefully recycle that in the form of buybacks. However, what I can also say is that if the investment environment changed significantly – which, by the way, we don't necessarily expect – then we might take that capital and put it into an investment opportunity, where that opportunity could generate returns above our cost of equity. So the capital is a fungible pot of resources that we could deploy to a range of different activities.

What we would like is all the capital surpluses to be sitting at the parent company so that we can make those choices freely. We have not been able to do that for many years, because of trapped capital, not just in the US but one or two other locations around the world. What we are doing through the various capital actions, through the work that we do with regulators to continue to improve the resilience of the businesses about which they are concerned, is creating the ability to centralise capital surpluses with the holding company and then make from time to time what we think are appropriate investment decisions, or capital allocation decisions, based on what we think the environment represents for us. And what we've done with the Brazilian proceeds is we do not see the opportunity to reinvest those proceeds profitably at this point in time; we sit with a consolidated capital equity – common equity tier 1 ratio which is above the midpoint of the range that we, and it would seem our regulators, are happy for us to operate within. We've got a UK business that's self-capitalising, that'll creep towards where it needs to be from a common equity tier 1 perspective, but if for some reason it doesn't, the reason we want to hold those capital resources at the centre is that if we need to capitalise that entity, we can easily downstream those resources.

We've done this from time to time in the past. When the Finance company got itself into difficulty between 2006 and 2010, we downstreamed resources from the Group to recapitalise it. When Argentina got into trouble in the early 2000s, we downstreamed resources to recapitalise Argentina and rebuild that business. So the entire approach to capital resource management within the Group is that the

subsidiaries generate profits, they pay surplus capital which they generate from those profits to the Group once they've met local regulatory requirements – to the parent. The parent either then uses that to fund the dividend, to fund investment decisions, and for the first time ever in our history, as far as we can tell, on this occasion fund a buy-back.

Manus Costello

And if next year HSBC Bank plc is still short of where you target – the 12-13% – you would still be happy buying back shares through the holdco, even though one of your major subsidiaries is short of where it needs to be and needs to generate that capital organically.

Iain Mackay

Provided I've got the adequate capital resources to push down to the subsidiary, then absolutely, yes.

I think there's another point which is any of these buybacks have got to be approved by the regulator, right? Exiting capital from the US has got to be approved by the Fed; doing a buy-back out of the holding company has to be approved by the PRA. So therefore, just as we have put a lot of effort and resources into building and improving our capital management capability – of which a great deal is to do about process and documentation – in the US, which allows us to pass CCAR, to get non-objections to our capital plans, to create the option, opportunity and possibility to upstream capital in future years, so we need to do the same really in every major regulated entity in the Group: demonstrate that we've got good capital management and planning processes in place; demonstrate that we've got the resilience of our subsidiaries and their ability to meet local regulatory capital requirements, that they self-capitalise and upstream dividends to the Group out of their capital resources which are generated from the profits of the Group. And that is what the PRA we fully expect and would expect to continue to challenge us on before they would allow us to do dividend payments, buybacks or any other significant capital action, which – up to and including acquisitions, conceivably, at any future point in time, were we to contemplate such a thing.

So, the role for the management team is to make sure that those capital resources, to the extent we exceed local regulatory requirements in the jurisdictions that they exist – is to create the capacity to get that surplus capital to the parent company, because it gives us the greatest resilience from a recovery and resolution perspective, which again ticks the box for regulators around the world, and it gives us the greatest flexibility in terms of then allocating that capital to where we can generate the best returns for the Group. And so there are still – for reasons emanating from the global financial crisis, restructuring that we've done within the Group, dispositions we've done within the Group over the last six years, we still have a number of actions to do to make sure that that surplus capital sits in the parent company to afford that maximum flexibility. Success in that helps inform our actions in future years.

Jane Leach, Group Capital Controller

Just one thing it might be worth adding: we mentioned the GB&M run-off just before that question, and most of the GB&M legacy run-off of course is UK, so that also does have an impact on the CET1 ratio going forward.

Sandy Chen, Cenkos

On Balance Sheet Management, could you sort of compare and contrast how you have approached Balance Sheet Management, what the guidance is moving forward, and what are the potential changes in rate environments and QE, etc. versus the sort of downward guidance that we're getting on structural hedges in some of your competitors?

Iain Mackay

The approach to Balance Sheet Management remains very, very consistent. I think Stuart mentioned guidance yesterday of between \$2.4 and \$2.8 billion annually from a BSM perspective. It is our corporate treasury function and it is managed extremely conservatively. It's very liquid, but the term on the book is about three years, which broadly speaking matches the term on the other side of the balance sheet. But about \$2.4 to \$2.8 billion is what we see coming through Balance Sheet Management this year.

Sandy Chen

That just seems quite robust, given what some of the others are saying in terms of guidance.

Iain Mackay

If the Monetary Policy Committee drops the interest rate by 25 basis points later today, that for us annually means in the UK business – sterling bloc – about \$200 million net interest income annually, so that's another \$200 million off from a sterling bloc perspective if the MPC does that. We obviously would prefer he doesn't, but we'll find out in a couple of hours.

Raul Sinha

In a hypothetical scenario, if we look at the BoCom VIU and the carrying value, it looks like at some point in the next six to 12 months they might converge within each other. You've talked about the focus on ROE quite a lot, and if you had to deconsolidate the earnings, that would be very ROE dilutive on a stated headline basis to the Group. I agree it might not impact your dividends – it's a non-cash item – but you're currently holding capital for BoCom and if you have to deconsolidate the P&L impact, that would be a negative hit to the ROE. So, given your ROE discipline, would I be wrong in assuming that if you got to the point of deconsolidation, we should think that you might actually look to exit the stake?

Iain Mackay

Interestingly, when you look at it on an ROE basis – on the constituent parts of the investment of the Group – and you look at BoCom as an investment that we hold, BoCom on a standalone basis – the contribution that it provides is very, very slightly accretive from an ROE perspective to the Group – very slightly. As we've talked about in the past, we get about \$500 million a year in dividends from BoCom, so the cash pay-out is about 20-25% that we get from BoCom, which is well below the ratio at which the subsidiaries that do pay dividends – pay dividends through to the parent.

On a return on risk-weighted assets measure, because of the regulatory treatment that the PRA applies, it is dilutive. There is quite a lot of RWAs attributed to it, and you're right: there is a significant amount of regulatory capital tied up in supporting that investment consequentially. One of the things that we continue to discuss with the PRA is aligning the regulatory capital treatment more closely to the accounting treatment, which would potentially result in that investment being treated as a deduction through the threshold, so as a material holding with a deduction through the thresholds regime, and that would result in, from a regulatory perspective, much less capital being allocated to support that investment in BoCom, which if we were to achieve that outcome would result in quite a significant positive impact to common equity tier 1.

Our threshold for recognising our share of net assets earnings of BoCom is the value in use. So, if the value in use were to drop below our carrying value, or if our carrying value were to step above the value in use, that would then determine the extent to which we could consolidate earnings from BoCom. Would that necessarily inform a decision to dispose of the investment? Not necessarily, no. Again, I think we will always look at the investment from an investment perspective. What we would clearly like to accomplish is what we think better aligns our regulatory capital treatment to the accounting recognition of this in the financial statements of the Group, so we continue to work that, but I think that is distinct from a decision around whether or not it would be appropriate to dispose of the investment.

Gurpreet Singh Sahi

The next plan on reallocation of capital to improve ROE in the Group, because it's still running, say, 10% ROE versus COE. So, looking beyond 2017, where could the focus be?

Iain Mackay

The best returns that we realise in the Group are in Asia, and so that's what informed the discussion in June of last year around reallocating capital as we release capital, and some of that capital actually is being released in Asia as we reshape portfolios within Global Banking and Markets and Commercial Banking. But in terms of future capital attribution, look around the businesses that generate attractive returns. Those sit in Asia; they sit in the Middle East and North Africa. The UK continues to be attractive, notwithstanding the trials and tribulations that we currently face in the UK geopolitics, but there are

certain lines of business within the UK which remain very attractive. The Canadian business, notwithstanding that they're going through a tough time right now with the oil and gas and the impact that has on their economy. So there are still a number of attractive investment opportunities which do generate returns well above our cost of equity, but Asia continues to be clearly a focus.

Katherine Lei, JPMorgan

Are there any factors that will lead to a potential de-recognition of BoCom's income? Say, for example, volatility in the earnings; something happens in China; or the stock market – say, for example, BoCom's valuation contracted another X or Y percentage points – things like that.

Second question is on the deployment of capital in Asia, because I understand that in Hong Kong recently, banks are actually aggressively competing for mortgages. Does that mean that the mortgage loan growth in the second quarter, or the second half, is going to be faster? And also on the Pearl River Delta, what kind of loan growth ratios will you be guiding? Say, for example, will it be more focusing on the state-owned enterprises (SOE)? On SOE – there will be the SOE reform. How would you – would that have an impact on loan growth in that part of the world?

Gavin Francis, Group Chief Accounting Officer

In terms of de-recognition, I think there are really two aspects to that. So, first of all is a possible impairment. That would be driven by obviously where value in use is compared to carrying value, so your question really is about what might drive the value in use that we have. That obviously is a forward-looking estimate of cash flows coming out of BoCom. That is quite closely calibrated to broker estimates about loan growth, etc., so that value in use does go up and down and is calibrated to what brokers are saying and our own judgment. So, some of the things you mention of course could impact value in use, which then could lead to an impairment. That's slightly separate to the question of, I guess, derecognition, which is really the word you used. That sort of comes back to the question that was asked previously: at what point might it cease to be an associate? That would take some change in our relationship with BoCom to basically drive a change in the current accounting treatment. So those are really the two aspects to think about.

Iain Mackay

In the Pearl River Delta, we've grown customer size, we've got loan growth, but where we're starting from is a very low base, and this is about development over the next three, five, seven years for a business for the long term; this is not about can we kind of induce short-term revenues by building a book of loans quickly. The risk appetite in the Pearl River Delta is set in a manner consistent with a very conservative underwriting standard for mainland China and for the businesses – globally in a consistent manner. So the loan growth is coming through quite nicely in Pearl River Delta, both within Retail Banking in mortgages, in Commercial Banking both across privately-owned enterprises (POE) and SOE, but we're talking about very small numbers starting from a very small base, so they barely show up in terms of having a real impact on Asia's revenues or profits at this point in time. But Peter Wong's view is very much about building progressively a robust business with many of the characteristics of the business in Hong Kong today, but it is about building something that's very robust and stable for the longer term.

In terms of mortgage activity in Hong Kong, we've got substantial market share there; it's around 20%. We compete aggressively in that space because market share's important to us, because it does support the cross-sell of other products to both our retail customers, both in the wealth management space and in the traditional banking space. The interesting thing around pricing on mortgages – you can't go much lower, right? You can't go much lower. It's very, very stable. When we look at net interest margin, notwithstanding what has been a very competitive environment in mortgages now for the last six or seven years, pricing on mortgages and margin on mortgages is very, very stable. To the extent we've actually seen any NIM compression in the second quarter, it's actually been from price competition on mortgages in the UK.

Steven Chan

Do you consider both Hongkong and Shanghai Bank and Hang Seng Bank overcapitalised?

Iain Mackay

You need to speak to our regulators about that.

Steven Chan

You mentioned many times about regulators, so you mean that the regulators expect Hang Seng to keep 16.8% CET1, which is well above the average, you know?

Iain Mackay

No, it's not, actually. You look across the Hong Kong bank population and our capital ratios, both for HBAP and Hang Seng, are pretty consistent with the population. Hang Seng and HBAP are bigger banks in Hong Kong, and I think it's a reasonable expectation from our regulators for the larger banks to be well capitalised and very robust. What we challenge our Asset Liability Capital Management teams around the world to do is ensure that when we meet local regulatory requirements, to the extent we can take any surplus capital – and we always have to agree with our regulator what is surplus to the regulatory requirement, and then upstream it. And that same practice applies equally to Hang Seng and HBAP.

Fiona Simpson, Morgan Stanley

On TLAC issuance, your very substantial deal earlier in the year. Any updates on thoughts on timing and cost of that issuance post-Brexit? Obviously we've seen the Lloyds deal come, which looked actually rather a wider spread than we might have thought pre the Brexit vote, so any thoughts there?

And then on the US capital and CCAR, DFAST. Obviously we'll see when the results for that come out, but subsequent to that, is there a further approval you'll need before you can go ahead and announce a buy-back? So we're talking, I assume, second half of next year, but any insight on the moving pieces there?

Iain Mackay

We need the Fed to approve the dividend from the US to the UK, and we would need the PRA to approve any buy-back or other capital action in the UK from the Holding Company.

On TLAC, we got about \$18.5 billion out in the first half. I think a lot of volatility in bank credit spreads in the first two months of the year didn't help the cost efficiency of that programme for anybody in the industry, but the spreads and pricing tightened significantly for us as we moved from March into April and through, and actually, broadly speaking, spreads have performed reasonably well. We absolutely are paying more for TLAC than we anticipated we would when we put our plan together in 2015. The same is true for Alternative Tier 1s and Tier 2 capital instruments. I think the credit rating for HSBC is extremely important. I think the fact that a number of the rating agencies have downgraded the UK has a muted knock-on effect because in the rating methodology, most of the rating agencies took any explicit sovereign support out of the bank ratings last year. So there shouldn't per se be a knock-on from the UK rating to the Bank rating, and per se, accordingly, we wouldn't expect the knock-on to pricing, but Brexit obviously sort of throws another monkey wrench in the middle of that whole thing.

We've done a great deal in the first year, in our view, and Bryan Pascoe's view as the Group Treasurer was to go hard and fast when the market was there and the pricing was reasonably good, so we did. Our approach to the second half will probably be slightly more measured, but we'll probably be out in the second half doing a little bit more. We won't do as much in the second half as we did in the first, for the simple fact that August is pretty sleepy for the market, so not a market that we would go into; December's pretty much a non-starter, so, it's going to be sort of September/October/November if we do anything, and obviously, for a good part of October we're closed, because we're doing the third quarter numbers. So, to the extent we do anything either in TLAC or capital instruments in the second half, it'll be smaller amounts, and hopefully we'll find windows in which we can do it at reasonably attractive pricing. But we're very, very happy in terms of how much we got out and eventually the pricing that we did in the first half on that.

Gurpreet Singh Sahi

There was an announcement the buy-back was only at the London Stock Exchange, why not also in HK?



Iain Mackay

Part of the resolution that we got approved at the Annual General Meeting both last year and this year requires the buy-back to be done on an exchange recognised by UK corporate law, by the Companies Act, right? For some reason the Hong Kong stock exchange is not a recognised exchange under UK corporate law. This is a resolution that goes in front of the company at the Annual General Meeting each year, so what our Corporate Secretary will be working on is hopefully coming up with an alternative wording that would allow us to do the buy-back on the Hong Kong exchange as well.

Dominic Chan, BNP Paribas

How should we be thinking about the target ROE of 10% from here? Are we talking about three to four years' timeframe? I know the share buy-back will help a little bit on the ROE, but it shouldn't help –

Iain Mackay

Not much. We'd have to take an awful lot of equity out to get our current level of returns up to 10%.

Dominic Chan

Things are getting tougher in the second half and probably 2017. How should we be thinking about that 10% target?

Iain Mackay

I think Stuart covered this yesterday. When we built our plan in 2015, we built all the returns off a 12.5% common equity tier 1, and although we'd taken what we thought was a very conservative stance on interest rate and forward curves in building that plan in 2015, we're way off that curve just now in 2016. 2017 isn't looking a heck of a lot better, so our view on interest rates is lower for longer. Levels of economic activity have reduced. Volumes we're seeing coming through have stepped off significantly from where they were when we were doing that plan in May and June of last year. You look at that from trade and receivables volumes; commodity pricing; the oil price.

So, there are things that we can, are and will continue to do. Cost management – Stuart said it yesterday: we'll nail our \$5 billion by the end of 2017. This is not just about getting \$5 billion out; it's about building an industrial cost management discipline within the firm – deliver cost productively year after year after year. So we will continue 2018 and 2019 and beyond on cost discipline management; efficient operating in the firm – that goes customer service the whole way back – continued capital management actions in terms of taking surplus-to-requirements capital out and either investing it in accretive business or returning it to shareholders; obviously, going after the revenue growth opportunities that we've got within the Group. 10% is the right place, because the cost of equity is somewhere between 9% and 10%, so notwithstanding the fact that the economic theorists in our regulators believe that our cost of equity should be lower, the investor community believes that it's still 9% to 10% cost of equity.

So, return on equity of 10% is what we have targeted. We're not changing that target, but we definitely see a lower for longer environment both in terms of interest rates and levels of economic activity. And frankly, there's not a politician in the world helping us. That's not fair; I'm sure there are lots of politicians in the world helping us, but in some of our major economies – you know, Brexit doesn't help. Now, we're not going to pin it at the door of Brexit, because frankly, we're well diversified: we've got a big business in France; we've got a business in Germany; we've got a good business in the UK; we've got a great business in Hong Kong; and we've got businesses that we're restructuring and redeveloping in some of the important markets around the world. But the geopolitics are creating uncertainty for the economy as a whole, and you can see that in terms of levels of consumer confidence and investor confidence, so it's lower for longer. We will do everything we need to do to strive towards 10%, but we're not putting a date on it.

Okay, I think that's it. Thank you very much for your time this morning.