Transcript – Q3 2019 Earnings Release
Investor and Analyst Call

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Corporate participants:
Noel Quinn, Interim Group Chief Executive
Ewen Stevenson, Group Chief Financial Officer

Noel Quinn
Good morning to everyone in London and good afternoon in Hong Kong. Welcome to our third-quarter results call. As you know, this is my first quarterly results update since taking over as Group CEO in August. I want to provide you with my views on business performance and the areas that are performing well, but also on those parts where we have performance issues and action is required. Ewen will then take you through the detail of our Q3 performance.

Reported profit before tax for the nine months was up 4% and the adjusted profits were broadly flat at $17.9 billion. Adjusted revenue for that same period was up 4.8%, which reflected strong performances in RBWM and CMB. Adjusted revenue in GB&M for the nine months was down 7% and the nine-month Group annualised RoTE was 9.5%. As a standalone quarter, Q3 was reassuring in some areas but disappointing in others. Reported profits were down 18% to $4.8 billion, and adjusted profits were down 12% to $5.3 billion, compared with last year’s third quarter. Adjusted revenue was down 2% to $13.3 billion. Our Asian businesses were once again the driving force, contributing 87% of Group adjusted profit before tax in the quarter. Commercial Banking continued to grow revenue and balances, particularly in Hong Kong and the UK. Retail Banking held up well in Hong Kong despite the current situation there. Customer redress charges obscured strong lending and deposit growth from our UK ring-fenced bank. Our transaction banking businesses showed good resilience and Global Private Banking continued to attract good levels of net new money. It was also good to see a continuation of the cost discipline from the early part of 2019.

However, we are clearly facing a more challenging revenue environment than in the first half of 2019 and the outlook for revenue growth is softer than we anticipated at the half year. For this reason, we no longer believe it possible to achieve a return on tangible equity of greater than 11% in 2020. Looking at our portfolio of businesses and geographies, it is clear that, while we have many parts of our portfolio that are performing well, we also have parts where the performance is not acceptable. Our continental European business and the non-ring-fenced bank in the UK are not producing acceptable returns, particularly in Global Banking and Markets. Given current market conditions, they are unlikely to do so unless we take decisive action. While our US commercial business grew revenue in the third quarter, our US business as a whole has an annualised return on tangible equity for the year to date of 1.9%. This is clearly well short of our 2020 target of 6%, which we have previously said we no longer expect to reach.

Having a strong presence in both continental Europe and the US is important, but we need to reshape our presence in both. It is now clear that our previous plans for both businesses are no longer sufficient, given the softer revenue outlook that we now face. The returns need to be improved and the capital allocated to those geographies needs to be reduced. We need to rebalance our capital away from low-return business into higher-growth, higher-return
opportunities in other parts of our footprint, and I am determined to do exactly that. As a consequence of these actions, it will be necessary to adjust the cost base of HSBC. We also need to remodel the organisational structure of HSBC to remove some of the complexity that has, I believe, been an obstacle to effective execution of our plans and also to reduce the costs associated with running the Group. We will provide an update on these plans alongside our full-year results in February and provide new financial targets at the same time.

I’d like to finish with a few words about Hong Kong and the UK. We are committed to supporting both Hong Kong and the UK through the current challenges they face, and I would like to acknowledge the exceptional work and dedication of our people in helping our customers during this current period of uncertainty. At different times throughout our 154-year history, both Hong Kong and the UK have faced significant challenges, and HSBC has done whatever we can to help them through to the other side. HSBC has always taken a long-term view and will continue to do so.

Ewen will now take you through our Q3 performance.

Ewen Stevenson

Thanks, Noel. Morning or afternoon, all. I’m now going to turn to the slide deck. So on slide 3, as you can see from today’s results and Noel’s commentary he’s just given, it was a mixed quarter overall with a more subdued outlook, but we’ve a substantive set of management actions underway to respond to this.

Reported profits after tax in the third quarter were some $3.8 billion. That is down 16% versus the third quarter in 2018. Underlying this on the positive side, Retail, Commercial and Private Banking had solid quarters, as did the transaction businesses and Global Banking and Markets. We’re constraining costs well below last year’s growth rate; we’re managing RWAs actively; and results out of Asia remain robust despite current challenges in Hong Kong. Against that, Global Markets had a weaker quarter, particularly compared to a very strong third quarter in 2018. We had a number of one-offs, including high remediation costs in the UK ring-fenced bank and negative market-related impacts, and credit charges were impacted by higher credit charges against unsecured lending and retail banking, and higher specific charges in commercial banking.

Turning to the next slide, total adjusted revenues in the third quarter were $13.3 billion. That’s down 2% on the third quarter in 2018. Looking across the four global businesses, in Retail Banking and Wealth Management, overall revenues were broadly stable. In Retail Banking, revenues were up 4%, driven by balance growth in both lending and deposits. Wealth Management revenues were down 6%, which was affected by $225 million of negative market impacts in our insurance-manufacturing business. Commercial Banking revenues were up 4%, largely through balance-sheet growth across all regions in credit and lending, and the benefit of wider margins in global liquidity and cash management. In Global Banking and Markets, revenues were down 15%, or 10% if you exclude negative credit and funding valuation adjustments, mainly from continuing weakness in global markets. Private Banking had another good quarter. Revenues were up 11% and total net new money inflows in the third quarter were $5 billion and $19 billion for the year to date. In the corporate centre, revenues were $194 million, up on the third quarter of 2018, driven by the reduced impact of hyperinflation accounting in Argentina together with favourable valuation differences on long-term debt and associated swaps.

On slide 5, net interest income was $7.7 billion. That’s up 3% on the third quarter in 2018. This reflects a mix of volume growth, up 7% over the last year, partially offset by slightly lower margins. For the third quarter, NIM was 156 basis points. That’s down six basis points on the second quarter. Customer redress of interest costs of $135 million in the UK ring-fenced bank accounted for three basis points of this, and the impact of hyperinflation in Argentina accounted for a further two basis points. Overall, despite an expected outlook of interest-rate softening, our two largest markets for net interest income, namely Hong Kong and the UK,
continued to see good volume growth. For Hong Kong, despite softness in US dollar interest rates, HIBOR remained somewhat elevated, with an average one-month HIBOR of 203 basis points in the quarter. That’s flat on the second quarter and up 72 basis points on the first quarter. I would note, though, that one-month HIBOR is currently about 30 basis points lower on average in the fourth quarter to date.

Turning to slide 6, I’m pleased with the better discipline we’ve been able to instil on costs this year. Compared to a growth rate of 5.6% in full year 2018, we’ve constrained adjusted cost growth to 2.6% in the first nine months. Third-quarter cost growth was flattered by certain items including Argentinian hyperinflation and the timing of investment spend. As I look at cost growth excluding these items, we’re running at about 3% cost growth for the first nine months and expect to be running at a similar growth rate for the fourth quarter. Importantly, we’re showing reduced cost growth while continuing to invest. Investment spend this year is currently at $3.3 billion. That’s up 13% versus the first nine months of last year. Given the weaker third-quarter performance relative to plan and compared to expectations at the second quarter, we have reduced year-to-date variable pay accrual by some $180 million. We will reduce it again in the fourth quarter, resulting in a full-year P&L benefit of around $300 million. As discussed at the second quarter, we’re now on track to take out $650 to $700 million from the full-year 2020 run rate. We’ve taken a further $120 million in total severance costs in the third quarter. As we progress the strategic work that Noel has talked about, we expect to strip out further costs as we execute against this, and this is likely to result in additional severance costs in full year 2020.

As a quick reminder, our fourth-quarter costs have the full impact of the annual UK bank levy. We expect this to be in the order of $950 million, broadly in line with the 2018 charge, and the fourth quarter will also include a further increase in investment spending of around $200 million. Our reported costs also include customer redress costs of $488 million. This includes $388 million relating to PPI, reflecting exceptionally high information requests in August ahead of the PPI deadline.

On the next slide, we saw higher credit costs in the third quarter, some $883 million or 34 basis points. This compares to $545 million or 22 basis points in the previous quarter. Underlying this are higher credit charges relating to unsecured lending and retail banking in the UK, the US and Mexico, higher charges against specific clients in Commercial Banking in both the UK and Hong Kong and movement from stage one to stage two loans particularly in Hong Kong, given changes in models and the updating of forward economic guidance. Credit costs in the third quarter included an additional $90 million charge to reflect the economic outlook in Hong Kong. We continue to stick to our guidance of 30 to 40 basis points of credit costs through the cycle and, based on the current economic outlook, we expect to be at the low end of this range during this financial year. The outlook for credit remains more uncertain than usual and ECLs remain sensitive to forward economic guidance, with Hong Kong and the UK in particular subject to a broad array of credit outcomes.

On slide 8, Core Tier 1 ratio at the end of the third quarter was stable at 14.3%, with profits and reductions in RWAs offset by dividends and the billion-dollar share buyback. We continue to actively manage RWAs across the Group. They were down $21 billion in the third quarter. RWA growth of $8 billion from lending growth and credit migration was outweighed by a $14 billion reduction from methodology and policy changes and a $13 billion reduction due to FX. We expect RWAs at year-end to be broadly similar to the end of 2018. We’ve now completed our billion-dollar buyback programme for the year. The average price of the programme was £6.02 per share, resulting in 136 million shares being bought back and cancelled.

So to conclude, on slide 9, if you strip back our third-quarter performance, I think we had a decent quarter in Hong Kong and Asia as well as the Middle East and Mexico. These businesses continue to generate attractive returns. Our areas of weakness were Argentina, the UK ring-fenced bank and the non-ring-fenced bank in the US. Argentina and the UK ring-fenced bank were both negatively affected largely by one-offs: in Argentina due to the macro
situation and in the UK ring-fenced bank due to $606 million of combined redress charges. For the non-ring-fenced bank and our US business combined, these are around $280 billion or 32% of total RWAs; approximately 85% of these RWAs are in Global Banking and Markets and Commercial Banking, with the bulk of Global Banking and Markets' RWAs being in the non-ring-fenced bank. And both businesses also have loss-making retail-banking operations. As part of the work we’re now doing, we expect to materially re-position both the non-ring-fenced bank and our US business, with a view to both improving currently unacceptable returns and to release capital through material RWA reductions.

Looking ahead to the fourth quarter, the UK and Hong Kong continue to have large deltas around them. Hong Kong is somewhat flattered by the continued strength in HIBOR, although the underlying Hong Kong macro data is weak. And the situation in the UK depends on Brexit outcomes. Also note that we could see significant charges in the fourth quarter and beyond, including the possible impairment of goodwill and additional restructuring charges.

So, to conclude, a tough quarter at the headline level, but masking some good underlying country and regional performance that continue to grow and produce attractive returns. Retail, Commercial and Private Banking had solid quarters, as did the transaction businesses in Global Banking and Markets. We’re constraining costs well below last year’s growth rate; we’re managing RWAs actively. But, with a weaker outlook, we need to accelerate action to redeploy capital into higher returns, and this will also support our current capital plans. We intend to sustain the dividend while maintaining our Core Tier 1 ratio above 14%.

With that, if we could please open up for questions.

**Tom Rayner, Numis Securities**

Hi, Ewen. Hi, Noel. Two questions, please. Firstly, just to see if I can get you to add any colour to the restructuring plans. It sounds from what Ewen has just said that the focus is going to be around the US and possibly parts of GB&M. You said ‘non-ring-fenced bank’. I’m assuming that’s predominantly GB&M. I just wonder if you can help us scale the size of potential RWAs that may be reduced and any sort of associated profits linked to those RWAs just so we can start to get a bit more of a feel for what may be coming.

And, just linked to that first question, if we are going to see material restructuring charges, I guess it’s sensible to assume that the sort of buyback commitment becomes a bit irrelevant in that scenario, so we should probably stop thinking about the buyback if we’re now going to be trying to scale restructuring.

I had a second question on Hong Kong, but I don’t know if you want to deal with the first one first.

**Noel Quinn**

Tom, let me take the first part of the first question, and then I’ll hand off to Ewen.

We acknowledge that the returns in continental Europe, including the non-ring-fenced bank and the US, aren’t where they need to be, so first we need to try and improve those returns. But also we need to reduce the amount of capital that’s associated with both of those geographies and try and redeploy some of that capital into higher-growth, higher-return opportunities elsewhere in our portfolio. The exact quantification of that redeployment and those actions we will communicate at the time of our Q4 results, so we’re not able to give you detail today on the exact quantification of that. But it’s fair to say that taking capital out of a region will take revenue out, and if we take revenue out we’re going to have to adjust the cost base that has supported that revenue. And that’s where the potential for restructuring charges comes from. But the detail will be provided at Q4. But I’ll let Ewen add some more colour to that.
Ewen Stevenson

We have been deliberately vague at this point, because we have kicked off a piece of work but it’s not sufficiently advanced to enable us to announce it at this point. The other thing I would note, we’ve got a new management team in the US that only started in their new roles just over three weeks ago, and they need time.

I did use the word ‘material’ deliberately, so think about it in that context. Typically, in terms of timeframe, I would expect that it will take us a couple of years to execute the bulk of that restructuring. And the other thing I would note as part of the announcement, too, is that Noel has also signalled a desire to go after the sort of complexity of the Group at the centre. So there’s quite a bit of cost complexity associated with that as well that we’re trying to unpick. And then you can go into the back of the slide presentation: we’ve set out what the nine-month performance was both for the non-ring-fenced bank and the US. You can see there $280 billion of RWAs not making a lot of money; you can see broadly how that sits across the businesses. I said 85% of it was Global Banking and Markets and Commercial Banking. So you can, I think, run some approximate maths on the back of that. I’m sure Richard and the team in IR can talk to you after the call as well.

On buybacks, I don’t think we’ve made any comment about ruling out buybacks. You know, you should imply in what I’ve said that we’re going to see significant RWA reduction coming out. Some of that will get absorbed by restructuring charges, but I would still expect there to be a material amount of RWA release, some of which we’ll use to redeplo into higher-growth regions where we can, some of which we’ll use to continue to support the dividend, and I would expect to have some buyback capacity out of that as well. We recognise the fact that the amount of scrip dividend that gets paid out each year is relatively dilutive, so we will continue to actively manage that through buybacks, with an overarching target of keeping our Core Tier 1 ratio above 14%.

Noel Quinn

Tom, just one other point of clarification. You shouldn’t assume that the corrective action that is appropriate for continental Europe is necessarily the same corrective action for the US. The market dynamics, as you know, of Europe are very different to the market dynamics of the US and therefore our remediation programme could be different in the US to that which we have in Europe.

Tom Rayner

Okay, brilliant, thank you. The second one was just on Hong Kong. Quite a lot of noise around the ECL charge. I wonder if you could just help split down what you’re seeing in terms of the underlying credit position of your books in Hong Kong versus the charge you’ve taken in Q3, which is obviously a big step up on Q2, driven by various assumption changes and IFRS9-related things. I wonder if you could help us get a sense of what’s happening to the actual underlying credit performance in the region.

Noel Quinn

The first comment I’ll make is that Hong Kong has had a very resilient performance in the first nine months of this year, particularly in Q3. And I’m talking in totality. Its revenue position, the size of the balance sheet, the deposit book – they’ve all been very resilient. But I’ll hand off to Ewen to comment specifically about the ECL position.

Ewen Stevenson

What you can see in the number is quite a significant step up from stage one to stage two. About half of that is just due to modelling changes. The forward economic guidance has changed and deteriorated, which led to the $90 million additional charge.
There are obviously two things hitting Hong Kong at the moment. One is the US-China trade dispute, where you can see trade numbers down materially in Hong Kong. And the second is the ongoing protests, which is impacting things like tourism numbers, hotel occupancy rates, retail. So the bit of the book that we’re most focused on is the small end of SMEs at the moment. That’s where we do see emerging signs of distress. As you know, the Hong Kong mortgage book is very low LTV. We’re feeling good about that. So the only area that we’re sort of slightly cautious on at the moment is the smaller end of SMEs. And I think the outlook for credit depends very much on those two exogenous events that we’re not in control of, which is, when and how does the trade dispute get resolved and similarly for the protests.

Tom Rayner

Lovely, thank you very much.

Benjamin Toms, RBC

Hi, guys. Thank you for taking my questions. The first one’s just really about the announcement of a new CEO. Do you expect that announcement to be made before giving the new targets to the market at the end of the year?

And secondly on the ECL – sorry to come back to it – I think you said there that you expect for the full year to be in the lower end of the range of 30 to 40 bps. Is it fair to say, then, that you expect the ECL charge to be higher in Q4 than Q3 or do you expect flattish quarter on quarter is a better description? Thank you.

Noel Quinn

I’ll take the first question and then hand back to Ewen for the second.

As Mark said at the time of the announcement of the change earlier this year, he expected the process to take between six and twelve months. The process is underway. It’s a decision the Board will take when they feel it’s appropriate. It’s not something I’m able to give any more detail on today. I’m part of the process, and I’m sure they’ll make a statement as and when they’re ready. In the interim, we’re running the business and trying to make the decisions that are appropriate for the business. We’ve got the full support of Mark and the Board to do what we need to do to improve the business in the meantime, and we’re operating on that basis, hence the announcements we’ve made today and the steers we’re giving you today.

Ewen Stevenson

Just from my perspective, to clarify on that, we definitely expect to be coming back to the market as part of full-year results with a revised set of financial targets, irrespective of where the Board sits in their CEO timetable at that point.

I did say I expect it to be at the low end of the 30 to 40 basis-point range. I don’t think we should try to be too precise on this. In particular I’d note that we’ve got a very sizable $400 million-plus overlay sitting in the UK. Depending on what happens around Brexit and politics in the next few months, that could either be too high or too low. And, equally, outcomes around Hong Kong can swing a bit as well depending on various factors which I mentioned earlier. But as we said today and based on what we see today, we expect to be at the very low end of that range.

Benjamin Toms

Thank you both.
Magdalena Stoklosa, Morgan Stanley

Good morning, good afternoon. Two questions from me here. One, I think I’m going to do a full round-up on the provisioning side and also then your lending businesses’ performance.

So we talked about the provisions in Hong Kong, but could you give us a sense of what you see in the UK and continental Europe? In your commentary, you’ve mentioned the unsecured credit deterioration in the UK but also a little bit in commercial as well, so any kind of detail there would be very useful for us. But also on the back of that and what you see on the ground, and your risk appetite into 2020, how do you actually see the loan volumes developing both in Hong Kong and the UK into 2020? Where do you see the demand and where do you see your business priorities to grow? Thank you.

Ewen Stevenson

Okay, look, on the UK, a few things. Part of the reason for the growth in credit impairments on the unsecured book is purely the fact, if you look at the growth characteristics, we’re continuing to grow UK, Mexican, US card portfolios, which the way that IFRS9 modelling works means that we will set up provisions against that as we grow it.

Commercial, I would say at this point – it does feel at the moment that, what we saw in the first couple of quarters in terms of being quite sector-specific and often quite unrelated to Brexit, for example trends in high-street retailing, has become a bit broader based at this point. But we’ll see. Brexit was always going to be slow burning, and it continues to be slow burning. The growth outlook for the UK, as we look at it, is expected to be relatively weak in the first half of next year.

But where do we see good credit growth? We continue to like the mortgage sector. We’ve now fully built up a broker network. I think we’re up to about 88% coverage. You can see in today’s numbers we grew flow share in the third quarter with 7.6%, which actually is our best quarter, I think, this year and our stock share is up to about 6.7% to 6.8% on the back of that. Actually, the average LTV of the book declined in the quarter. So mortgages would be one area where I think we’re going to take share, and we continue to have a degree of excess liquidity in the UK.

I think in Hong Kong, we grew the loan book by about 2% in the quarter. I think we will become increasingly selective, while recognising the fact that across our own business and Hang Seng we are collectively 40-50% of the market in most sectors. So the extent that there’s a slowdown in the Hong Kong economy, it’s hard to see that we wouldn’t just slow down proportionately with that. And to the extent that there’s a deterioration in credit, we will be exposed to that deterioration in credit.

Noel Quinn

The only other thing I would say on top of that is, if you look at Asia as a trading bloc, there is still growth within Asia. China is still growing, granted at a slower pace than we’ve seen in recent times, but it’s still a growth market. And trade within Asia and intra-Asia trade is still a growth market. So we still believe there are opportunities for growth, but we need to be a little bit more cautious – and it’s hard to predict what that future growth will be.

Ewen Stevenson

You also had a question on continental Europe. I think there was one single-name exposure in France which contributed to the credit charges in the quarter as well.

Magdalena Stoklosa

Perfect, thank you very much.
Good morning, a couple of follow-ups with respect to the strategy and plans going into 2020. The first is the severance charge versus savings for 2019 is a one-to-one relationship. Is there any reason to think that would be different going forward for any updated strategy?

Second question would just be anything you could elaborate on with respect to the FSB announcement coming out mid-November on G-SIBs and any expectations you have for that, because obviously your capital position does potentially impact on how much restructuring charge you can book.

And then, finally, when you talk about GB&M, taking capital out of that business – if I could just ask you, where is the bulk of the capital in that business? Where does it sit? So, of the $246 billion of RWAs, I’d have always thought Banking, HSS, GLCM, GTRF are relatively low-risk intensity. Equities, which has obviously got a lot of attention in the press, quite low too – high on leverage but low on RWAs. And I’d have thought a lot of the RWAs sit in Fixed Income, most notably Rates and Credit, but if you could elaborate a bit more there I’d appreciate it. Thank you.

Okay, what we’ll do is we’ll take the third question first, and I’ll just make a few opening comments and then hand over to Ewen, and then he can handle question one and question two as well.

On the first question, just remember that, actually, within our Asia franchise we had a very strong performance from GB&M in Asia. So we’re focusing in on the deployment of our RWAs in continental Europe and the US as the areas that require focus. And one of the recipients of that refocusing of capital could well be GB&M in Asia and elsewhere in the world, particularly in the Middle East as well. So there are both positives and challenges within the GB&M results, and I just want to draw attention to that. You know our Asian heritage; you know our heritage in the emerging markets as a wholesale bank, and that’s true both in GB&M and in Commercial Banking.

I’ll hand over now to Ewen specifically on the composition of the RWAs in continental Europe, but it’s fair to say that there are RWAs tied up in both our Markets business and in our Banking business, and we need to look at the efficiency of both of those RWA deployments. It isn’t one or the other.

Andy, the assumption we don’t have a lot of RWAs in our Global Banking business is not right, because that’s where all of the lending business in support of both the transaction businesses and parts of the Global Markets business. So the bulk of the RWAs actually sit within Global Banking and Global Markets. There are relatively limited RWAs against the transaction businesses. And then there are decent chunks of operational risk there as well. If you follow up with IR afterwards, we’ll be able to get you some additional colour in terms of what we’ve disclosed to the market so far.

But the other thing I would just reiterate: we do intend to continue to have a presence in continental Europe and the US after this reshaping, after this remodelling. We are a global wholesale bank serving both the very largest of multinational corporates but also, uniquely for HSBC, the middle-market entrepreneur-owned businesses on a global basis. And we therefore need to be able to be a lender and a transaction bank for those clients across our global footprint. It’s a question of the amount of capital we utilise in each area of that footprint.
and how much we deploy in continental Europe relative to elsewhere. I just want to reiterate: it will be a global footprint, but the distribution of assets will change over time.

**Andrew Coombs**

Before we move on to the other two questions, it sounds like it's more about reshaping the business, so reallocating RWAs from one region to another rather than an absolute extraction of RWAs. Is that fair?

**Noel Quinn**

No, it's not necessarily… It's too early to assume that. I think there will be an element of redeployment into other opportunities, but there may well be a utilisation of or a freeing up of the RWAs to benefit the Group as a whole. So I think that's the detail we will bring forward for you when we do our Q4 update. So it will be redeployment and potentially creating greater capacity.

**Ewen Stevenson**

When you look at the business overall, Andy, in Global Banking and Markets, it varies quite significantly depending on which region you’re looking at. I mean, Asia, for example, was about 50% of the revenues and 80% of the profits. And about $160 billion of the RWAs of the $280 billion sits across the non-ring-fenced bank and the US.

On your other two questions, I think, look, assuming one-for-one severance costs versus annual benefit is as good an estimate as we would have at this point.

On the FSB, you're right: I think we are expecting an update on the G-SIBs either in the second or third week of November. We are at the cusp, I think, of bouncing between the current bucket and going up a bucket. A couple of things on that; that doesn’t necessarily mean that the 14% capital target would change. We would have to work through the detail on that. The other thing I would say is that since year end 2018 – and some of the stuff that we’ve been talking about today but also some areas that we’ve been able to act on, we would expect our G-SIB indicators to be coming down sufficiently so that we would be able to get back into the current bucket that we sit. The last thing I would say is that, on top of that, the G-SIB indicators are all going to change. So we need to work through the detail of that in 2020. But I wouldn’t assume, if that announcement comes out, if we’re up a bucket in two to three weeks’ time, that you will see us adjusting our 14% target. I think we need to work through a lot of detail before we would get to that sort of conclusion, and we would try to actively manage the business so that wasn’t the outcome.

**Andrew Coombs**

Right, thank you both.

**Raul Sinha, JP Morgan**

Hi, thanks very much for taking my questions. Maybe a couple, please. Firstly, on the RWA guidance, I was wondering whether you might be able to unpick a little bit the 4Q guide that RWAs are going to be broadly stable. How much of that is an expectation of maybe slower loan growth versus potential model benefits that you’re still expecting to come through in the fourth quarter.

And then I don’t know if you even have any further discussion or commentary around Basel III and the sort of overall impact on HSBC. Just given all of the commentary we’ve had today in terms of RWAs, that seems to be quite an important, big part of the puzzle that we’re still missing. So any further commentary around Basel IV impact would be helpful. Thanks.
Ewen Stevenson

On RWAs for the fourth quarter, I guess there’s pluses and minuses. We do think we’re going to continue to see growth in RWAs as a result of business growth. Some of the big FX benefit that we got in Q3, we do expect some reversal of that. Offsetting that we continue to see – we’ve always signalled that we had a set of RWA mitigation actions that we described them, that we thought were going to be biased to the second half. We still see a decent amount of those coming through in Q4, including model benefits and some recycling of RWAs out of some corporate relationships. We do think that gets you broadly to net stable for the quarter.

On Basel 3.1, actually, as the regulators are calling it rather than four, there’s sort of two things. There’s both Basel 3.1 and there’s also potentially some impact on Brexit. We do, I think, recognise the fact that we’ve been short of guidance to the market. I would observe that since I’ve been in my job for the last few quarters actually the position’s continued to improve for us relative to where I would’ve expected when I first joined. Particularly the near-term impact from 1 January 2022. If that’s – we’re all being asked to assume that Basel’s going to get introduced on 1 January 2022. I think for many of us we still think that looks ambitious, and that timetable could slip. I don’t think we’ll get clarity from Europe and the UK until first half of the next year on the actual timetable. One of the complications in the UK is obviously the Bank of England doesn’t know whether they’re having to comply with European directives, or whether they’re independent of Europe at that point, and if they’re independent of Europe whether they’re going to seek to achieve full equivalence, or partial equivalence or not. So I do expect the impact to be, at least initially, a lot lower than what some commentators have been observing to date. And then you have to model out five years and say, ‘At what point do the output floors then bite?’ And we do think further out, in some ways, the lower the impact out front there’ll still be a larger impact once the output floors hit in the future.

As I say, I think where I’ve been talking to Richard O’Connor, I think we do plan to come back at full-year results and provide as much guidance as we can at that point, because we appreciate that it is a missing piece of the puzzle.

Raul Sinha

Thanks. It sounds like we’re going to be talking about this for years. I was wondering if I could have another one on Hong Kong deposits, particularly for Noel. What was interesting for me was that Commercial Banking deposits saw a bigger downtick in Hong Kong compared to Retail Banking or Private Banking, and I guess that chimes in with some of your commentary around small business. What are you expecting in terms of future trends on the deposit side? Do you think that we’re likely to see any material deposit outflows, or do you think that the performance we’ve seen so far in Q3 broadly reflects the worst of the changes?

Noel Quinn

I wouldn’t read movement in the Commercial Banking deposit book as a function of unrest in Hong Kong. That fluctuates up and down. On a normalised basis, it can fluctuate quite significantly. Remember, the Commercial Banking business covers everything from small SMEs through to very large multi-national corporates. That can move quite a bit quarter to quarter, based on individual transactions that may or may not be taking place in any one of those clients in that book. So I wouldn’t over-read the Commercial Banking deposit movement as a linkage to the situation in Hong Kong.

If I now turn to the Retail deposit book, the quantum of deposits in our balance sheet at the end of Q3 I think was broadly flat to the end of half year and slightly up on the beginning of the year. It remained resilient and strong. Clearly underneath that is the potential movement in and out of that deposit book, but we’ve seen relatively small amounts of movement out of that deposit book into other parts of the world. Very immaterial movements. And overall the deposit book has grown. So it’s proven to be very resilient. There have been
a number of very high net worth/ultra-high net worth clients who have put contingency plans in place by opening bank accounts elsewhere in the world, but there’s been very little – relatively little movement of funds into those bank accounts. The funds have remained in Hong Kong.

Chris Manners, Barclays

Just a couple of questions, if I may. The first one was just on the UK net interest margin. If we adjust for customer redress in the NII line it looks like it’s only gone down a couple of basis points quarter on quarter. Could you maybe just help us a little bit with the dynamics of what we should be expecting for next year, maybe just in terms of the structural hedge, the mortgage competition and a bit around that? The second question was just on the outlook for your associates. Obviously, you’ve seen high loan losses in Saudi British and expenses with Alawwal, and I guess when we look at where BoCom’s concentrating on a PE and then people obviously are a little bit concerned about the profitability there. Could you help us a little bit about how we should model that associate income going forward? I know you talked about goodwill write-downs. Are you still happy with the valuation of both on the balance sheet as well?

Ewen Stevenson

On the investment in Saudi, Chris, there were some one-offs associated with the merger that would’ve appeared in the Saudi associate in second quarter that we’ve picked up in our third quarter results. So there were one-offs, about $140 million in impairments. So you should, in a way, just assume that we go back to normalised associate income out of that stake, and that that was just a one-off measure related impact. BoCom, no change in position. You shouldn’t read anything into today’s announcement as to a change in relation to our stance on BoCom. Again, I’ve had several of these calls now where I’ve observed that the market value is below the value in use, but the actual amount of capital that we’ve got against BoCom is about $10-11 billion rather than $18 billion of value in use. So those goodwill impairments, or potential goodwill impairments that were highlighted today, I think if you go into the annual report and accounts there’s a note there on goodwill that provides some colour, but you’ll see a material amount of goodwill still sitting against the European business and the Global Banking and Markets business.

On UK NIM, you know I don’t like forecasting NIM, but there will be a continued shift towards mortgage growth. I think the outlook for UK rates, I think consensus is for a further rate cut at some point in the coming months, so all of that I think is going to impact NIM negatively over time. You’re right, if you back out the redress costs that were sitting against interest income, I think that accounts for 18 basis points of the 20 basis points of NIM reduction in the UK. But I would think that NIM in the UK continues to gradually reduce over the coming quarters. But that can obviously change if suddenly we have a different rate stance coming out of whatever comes out of Brexit.

Chris Manners

Got you. Could I just ask one follow up on your jaws guidance? I think when we were speaking at Q2 that you’d still said you’re going to do positive jaws each year. You’ve actually got good jaws performance so far, the 2.2% year to date. And as I remember, Q4 last year was quite a difficult quarter. Is there any reason you’ve removed that jaws comment at all?

Ewen Stevenson

No. Don’t read anything into that. Jaws is inelegant in that it relies on some revenue line items that we don’t control. If you looked at what happened in fourth quarter of last year, we had a very weak set of markets in the final six weeks of the year. We lost about $1 billion of revenue through no fault of our own, just because of what was happening in the markets, which impacted both Global Banking and Markets and our Insurance Manufacturing
business, so we went from what we thought was going to be positive 1% jaws to negative 1% jaws. Assuming nothing untoward happens in the market, we’re sitting at 2.2% I think for the first nine months. We would expect to have positive jaws for the full year. But we are managing both to absolute costs and to jaws at this point. As I said, we’re pleased with the fact that we’ve taken absolute cost growth down this year quite materially relative to last year’s run rate. And I would expect that absolute cost growth continues to reduce from here.

**Noel Quinn**

What I said in the opening statement was we will update our detailed plans with our Q4 results, and we’ll update at that point what targets we operate to on a go forward basis, when we do that update with the Q4 results.

**Chris Manners**

Okay, understood. So we might see a “dollar billion” cost target instead of a jaws one.

**Noel Quinn**

I’m not going to pre-judge what we’ll say at Q4.

**Manus Costello, Autonomous**

I wanted to ask, please, about the path of your capital development over the next 12 to 18 months. You’ve given us some indication of where you’re going to go after RWAs, and some are going to be freed up and some recycled. But between here and there there’s obviously some significant potential charges to come, and as you have pointed out the outlook in your two core home markets is quite uncertain. My specific question is how much tolerance would you have to go below a 14% core Tier 1 ratio, because once you put restructuring charges in you’re pretty close to it? And secondly, what’s your tolerance on the dividend payout ratio going upwards, north of 100% potentially, during the course of the restructuring period?

Thank you.

**Ewen Stevenson**

Just a few things. Obviously the 14% is a number that’s a reasonably robust capital target for us, based on the fact that we need to, under the Bank of England stress testing rules, be able to survive a global synchronised downturn. So in some ways how we’re stressed is a more extreme stress test than a UK domestic bank, because the type of event that we’re modelling is a more severe, tail risk event. In return for that, you should therefore expect that we’re a more resilient bank through market cycles, have better ratings, lower wholesale funding costs, all of which you see.

In terms of dividend, remember that there is a significant component each year, 20-25%, that’s paid out by way of scrip. So if you look at last year there was an 80% pay-out ratio, but the actual cash pay-out, pre buyback, was about a 60% pay-out ratio. So there’s a considerable flex in there, I think, for us to moderate the buyback or stop a buyback, which provides significant additional flex, I think, and therefore why we’re able to say that we intend to continue with the current sustainable dividend policy.

You’re right that there are a whole bunch of one-offs on the horizon. We’re dealing with Brexit, credit migration, which can swing both ways, frankly, we’ve got, for example, over $400 million of overlays in the UK for Brexit that if we got to a softer version of that some of that could get written back. We’ve got Basel on the horizon, but as I said earlier I don’t think – as we model that through the upfront impacts, I think they’re going to be at the lower end of what we may have expected six months ago, and the timing of when that’s going to impact us I think looks uncertain.
But overall, I think what’s probably the thing to flex is probably buybacks. The 14% target is a reasonably robust target. I think we would not want to fall below that for anything other than a very, very limited period. And we do appreciate that the cash dividend is a very important underpinning to the current share price.

**Manus Costello**

And just to follow up then, if the G-SIB buffer does go up, and you’re looking at a delta to MDA to your target of about 200 basis points, I think it would be, do you think that’s the right level? Do you look to delta to MDA as one of your guiding principles, or is it more what you get in your Pillar 2B out of the stress test that will guide you?

**Ewen Stevenson**

Well, it’s everything that guides us. But as I said earlier, just because the G-SIB indicators go up – increasingly the G-SIB indicators are a relatively blunt, and I would argue outdated, tool in that it’s 11 indicators governing our capital structure. Far more important, I think, is what sits behind our stress testing analysis and all of the work that goes behind that as to how much capital we need. I also said that even if our G-SIB buffer was to go up, I think as we said today we’ve already mitigated a lot of that increase that we saw during 2018. We’ve got a new set of G-SIB indicators coming in place, and therefore we would see it as a – view it as a relatively temporary uplift in the underlying capital requirements of the Bank. We do expect some RWA increases coming out of Basel reform, which again is another offset to that, and I do think in terms of the signalled reduction in RWAs out of the non-ring fenced bank in the US will also provide an important source of capital underpinning to us.

**Manus Costello**

Just to be clear, then, if you went below 14 it would only be for a very brief period, is what you just said, so maybe one quarter just below.

**Ewen Stevenson**

Yes.

**Manus Costello**

Got it. Thank you.

**Jason Napier, UBS**

If I could, good morning. The first, just looking at GB&M. I wonder if you could give us a sense of what the RoTEs are within Markets as opposed to the rest of that business. Secondly, on Basel 4, and I think we’re probably are going to be talking about this for an extended period, I wonder whether you could just give us a sense as to which areas, whether it’s by division or rule type, the Bank is most sensitive to. Thirdly, I appreciate that you’re not keen on NIM guidance, but I wonder whether you might give us a sense if yield curves stay where they are what sort of headwind around net interest income in dollars might be over the next year, because I don’t think we’re fans of a parallel shift in yield curve disclosures either. If you could just give us a sense of what the planning assumptions might be if we stayed here for 12 months. Thank you.

**Ewen Stevenson**

On the last one I would, even though you don’t like it Jason, refer you back to our interest rate sensitivity. The fact is we have a relatively short-dated book because of a combination of the way that both the assets and liabilities are re-priced in Hong Kong, and also the trade book in Commercial is relatively short-dated. So if you compare us to other banks typically
you get most of the five-year impact of a shift in the yield curve happening the first two years. So to the extent that dollar interest rates declined sharply and on the back of that that HIBOR has some impact as well, you will see that flowing through the numbers over a couple of quarters pretty quickly, I think. So depending on where we end up on dollar interest rates next year, we do expect some material impact and, hence, that was probably the biggest core underpinning of why today we’ve announced that we’re not sticking to our 11% RoTE target for next year. That, together with the fact that we think the outlook for Global Banking and Markets has deteriorated as we look at things today, relative to what we would’ve thought a quarter ago.

On the RoTE, it's a bit simplistic to look at Global Markets versus Global Banking, because Global Banking tends to have very low RoTE, because it has the bulk of the lending book sitting there. But that lending book supports both the transaction businesses and the Global Markets business to some extent. Within Global Markets, though, the FX business is a fantastic business. Top three globally, makes very good returns, very linked in to the underlying customer franchise business far more than some of our peers. And it would be the other parts of Global Markets that tend to have lower returns, the other FICC businesses and Equities. But even on our own internal analysis it’s a bit simplistic, because we couldn’t do parts of that business without the lending support.

Noel Quinn

Our core focus is on understanding customer profitability and the build out of that total relationship, rather than purely measuring profitability at a product level. So our orientation is around the customer profitability more so than individual product profitability.

Ewen Stevenson

And then the question on Basel 3.1, Global Banking and Markets, does have the disproportionate hit from Basel 3.1 reform. I think in many of the other markets there may be a longer dated impact from output floors, but I think you have to speculate about how the book develops. But in most markets the output floor is not a dramatic impact. But I think partly that will depend on the development of the mortgage franchise in some markets.

Jason Napier

That makes sense. Thank you.

Guy Stebbings, Exane BNP Paribas

Thanks for taking my questions. Just one back on strategy, and then two very quick ones, points of clarification. On strategy, I appreciate you want to wait for the formal update before giving us any more colour on the precise details, but when you’re talking about unlikely to make adequate returns in certain areas in the current environment, is the current environment that you have in mind when you’re thinking about how you reshape the business, or are you working towards a target structure that assumes things will improve slightly from here when you’re thinking about long-run cost base, capital allocation etc? And two points of clarification. One was on Hong Kong impairments. I think you said, Ewen, in response to a previous question, that about half the move in stage two was one-off in nature from model changes. Is that right? Just saw that in wholesale stage two exposures jumped from I think 3% to 8% of Group. So should we think about half of that as a reasonable guide to underlying stage migration, or is there something else going on which might be overstating that move?

Ewen Stevenson

No, it's half of it is what I said from model changes.
Guy Stebbings

Okay, perfect. And then, sorry, I’ve one other one, which is on the G-SIB, if I can. I appreciate if you go up next month there are certain aspects that might come down next year, such as the complexity score, I presume. But you also reference changes to the approach itself, which I would’ve thought would be a net headwind for HSBC, or is that wrong to assume? Thanks.

Ewen Stevenson

On the changes to the G-SIB indicators, possibly, but it’s not just potential restructuring. We’ve also been able to take action, for example on derivative gross ups and the 2018 submission, where our G-SIB score today would be materially lower than what it would’ve been at the end of 2018. So we do think whatever comes out of G-SIB is a manageable outcome for us, particularly in the context of RWA inflation coming out of Basel 3.1.

Noel Quinn

On strategy, clearly there’s the remodelling that we’re talking about and the reshaping of the portfolio. It’s not just the today issue. We’ve had return issues for a while in continental Europe and the US, but I think those – the actions need to be more urgent now, because the economic environment we’re facing is very different today than that which we assumed 18 months ago when we did the strategic plan update 18 months ago. So I think it’s appropriate for us to take the action. The action isn’t just predicated upon current trading conditions. We’ve had challenges in both of those portfolios for a while. But the ability to turn around those businesses in today’s economic conditions has been hampered, hence the desire to take action now. So I don’t think we should assume that the economic environment in continental Europe is going to significantly improve any time soon. And therefore we want to take action.

I did draw attention to the fact that the strategy and the way forward for the US may be different to that for continental Europe, because the market circumstances in the US are different to the market circumstances that exist in Europe. And that’s why I think it’s appropriate we give the management teams time to work out the detail between now and the end of year, so we can give you a full update with the Q4 results.

Guy Stebbings

Okay, thank you.

Noel Quinn

If I can now just close with a few comments, please. I would like you to remember the following. We have a global wholesale business with deep roots and heritage in Asia, and the world’s fastest growing markets. That remains uniquely placed to connect both large multinationals and mid-market entrepreneur-owned businesses to the world. We also have powerful and profitable Retail Banking and Wealth Management businesses in our biggest markets. This combination has demonstrated, time and again, its ability to provide strong profits and good returns for shareholders, and is integral to the HSBC history, identity and investment case. However, we also have parts of our portfolio that are not delivering acceptable returns, and given the changes to the external environment we need to accelerate our plans to remodel these parts of our business portfolio, which is exactly what I intend to do.

If you have any further questions following this call, then Richard O’Connor and the rest of the IR team will be pleased to help you. Thank you for joining us today.
Forward-looking statements

This presentation and subsequent discussion may contain certain forward-looking statements with respect to the financial condition, results of operations, capital position and business of the Group. These forward-looking statements represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Additional detailed information concerning important factors that could cause actual results to differ materially is available in our Interim Report. Past performance cannot be relied on as a guide to future performance. This presentation contains non-GAAP financial information. Reconciliation of non-GAAP financial measurements to the most directly comparable measures under GAAP are provided in the 'reconciliations of non-GAAP financial measures' supplement available at https://www.hsbc.com.