Transcript

Analyst Meeting

Q3 Results

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Corporate participants:
Ewen Stevenson, Group Chief Financial Officer
Ming Lau, Chief Financial Officer, Asia Pacific
Richard O'Connor, Group Head of Investor Relations
Gavin Francis, Chief Financial Officer, Global Banking and Markets
Kathleen Gan, Finance Director
Mark Phin, Head of Investor Relations, Asia Pacific

HSBC

Ewen Stevenson

So thanks everyone for coming. I'm actually not planning to give any introductory remarks. I was going to move straight into Q&A, starting here in London. But I think when you ask your question, if you can just say who you are and where you're from. It is all being recorded and transcribed, so be pleasant.

In Hong Kong, Mark Phin, who I think you all know, and Ming Lau, who you may not know, who's our new CFO for Asia-Pac. Gavin Francis here, who's actually just in the middle of transferring jobs. He's just finished as Chief Accounting Officer. He's signed off his last set of quarterly accounts and he's just been appointed as CFO for Global Banking and Markets. And Kathleen Gan, next to him – Kathleen used to be CFO for Asia and is now Director of Finance, running all of the sort of central part of finance with me. So, with that…

Richard O'Connor

There'll be a mic coming around to you, so if you wait for the mic and give your name and institution, that'd be perfect. Who wants to go first?

Martin Leitgeb, Goldman Sachs

Good morning. Just coming back to yesterday's presentation and the comments made around reallocating capital away from low returning businesses such as the non-ring-fenced bank, continental Europe and the US, I think I'm understanding from the comments it appears that, number one, your expectation is that from this process you expect to free up a material quantum of capital and, number two, that this capital can then be utilised either to support buybacks or to support growth initiatives elsewhere within the Group. I was just wondering whether you could shed a bit of light on how you think about the opportunity here to return capital versus growth and where you would see growth opportunities within the Group, without pre-empting, obviously, the February update planned.

And the second question, with regards to the UK, the UK at the moment consumes around 29% of capital. So, depending on how the cuts in capital in the non-ring-fenced bank progress, it could be that the UK is a third of capital or potentially even slightly higher. How do you think about how big the UK should be in the context of a future HSBC? Thank you.

Ewen Stevenson

In terms of the maths, $280 billion of risk-weighted assets are sitting across the US and Europe non-ring-fenced bank. And I did use the term 'material' yesterday quite deliberately. In terms of redeployment of that capital, I think there's a third use, too. Some of it obviously has to be used to fund the restructuring, but we do think out of that there will be a material amount of capital release. We're just actually in the middle of the annual budgeting process, so we've actually gone to those parts of the businesses that we think are capable of earning decent returns and saying to them, 'Look, if you were less constrained, please come back with what you think the incremental capital usage you could put in place.' There's obviously the possibility to do small bolt-on acquisitions. I don't think we're frankly, we're not looking at anything substantial anywhere in the Group at the moment, but it would provide us with some M&A flexibility that we don't have today. And then the remaining amount we can obviously use to do buybacks. But we don't have a developed view on, you know, how that capital is going to be used across those various elements at the moment.

And just sort of on the buybacks I know there was a bit of confusion yesterday, but, just to be clear, we manage to the Bank maintaining a Core Tier 1 ratio above 14%, and that is a more important requirement for us than managing scrip neutralisation. So to the extent that we have excess capital, we can see that the scrip does create quite a bit of dilution on an ongoing basis. We would like to reduce that dilution, but in some senses we're not just trying to solve for pure dynamic of scrip neutralisation. I mean, if you look this year, for example, the billion-dollar buyback that we've just executed doesn't solve the scrip neutralisation – what it will solve for this year is maintaining a Core Tier 1 ratio above 14%. So if we generate more excess capital as a result of the restructuring, it will give us buyback capacity, and the buyback capacity may or may not exceed scrip neutralisation in the future.

On the UK, I don't think we have a well formed view on what would be the ideal amount of capital to allocate to the UK relative to the rest of the Group. We think the UK is an attractive retail and commercial banking market. It produces good returns. We think that we have the capacity to continue to grow faster than market here in some customer segments and some product segments, given the nature of the balance sheet we've got. So for the time being we're not we're having an active debate on what the right amount of capital is to allocate to the UK.

Richard O'Connor

Just on the schedule we've sent around the non-ring-fenced bank, you can see GB&M is about two thirds. Clearly, a lot of GB&M business is booked in London. Therefore, London is a traditional booking centre. That will be in the UK. Clearly, we may move more things to France, but just have a look at that and have a think about that GB&M piece, which is a very large chunk of that is London-booking.

Robert Sage, Macquarie Group

It's really looking again, sort of further to the previous question, at the sort of scale of this. $280 billion is a very big number. And I remember back in 2015 – and I appreciate the current management team wasn't there, but they went through a similar sort of redeployment exercise where they said they were basically going to get rid of all the RWAs not generating a sort of hurdle rate of return. Sort of clearly here now it's a very big number that you're targeting. I was just sort of wondering if we could sort of make sense out of this in terms of it being different maths or if the environment has changed very substantially relative to where it was back in 2015 which invalidates the return hurdles for some of those RWAs.

Sort of perhaps an associated question on that: $280 billion – presumably a lot of those are generating sort of good returns, and it's only a sort of subset of that that you're talking about. And I was wondering whether you could give any sort of feel in terms of what the actual quantification of what the subpart of these RWAs might be within the $280 billion.

Ewen Stevenson

Well, I think if you look at the returns across that $280 billion, it made about a 1% return on tangible equity both pre and post tax in the first nine months. So I think you would intuitively be surprised if the majority of that was earning returns above the cost of capital, because mathematically that wouldn't make sense with that combined outcome. So what's changed? Well, in Europe I would argue a very good bank trying to do wholesale banking outside of its domestic market may be able to make a return in the mid-single digits in this interest-rate environment. So, I mean, Europe fundamentally is destroying value for any corporate wholesale bank today, I think, outside of a handful of domestic markets. And that has persisted for 10 years now, at least since the financial crisis.

In the old days, pre crisis, a single-A rated bank would fund cheaper than the single-A rated corporate they were lending to, and they wouldn't have to put up a lot of capital against the loan, so the cost of the relationship was relatively cheap. Since the financial crisis that has no longer existed. The single-A rated bank funds more expensively than the person they are lending the money to. They have to put up a lot of capital to it and the fee pool available to the banks hasn't fundamentally changed or, if anything, has reduced. So there's a lack of consolidation driven by regulators in Europe, so you're not seeing what should be the normal competitive response. I think the challenge in Europe is fundamentally different to the challenge in the US. The challenge in Europe is, how do you create a model that probably destroys value, whatever you restructure to, but destroys less value than what we are destroying today. But we want and need to be in support in Europe in order to support the global network bank that we want to have.

In the US, I think what has changed in the last year or so is a fundamentally different view on the outlook for US rates. When we put out the plan in June 2018, we probably thought the US rate environment in 2020 was probably going to be a couple of hundred, if not more than that, higher in terms of interest rates. That fundamentally changes the economics of our business model in the US. But you look at the US generally and you see that banks of similar scale or even slightly smaller scale to us are capable of generating appropriate returns. It's just the business as we've got it constructed is not doing that. The previous answer was to grow, to grow to scale the returns. I think the new answer will be to reduce and improve returns.

Richard O'Connor

If you look at slides 26 and 27, we split out the businesses in the US and the non-ring-fenced, and you can see that CMB has a different profitability to RBWM and GB&M, so I'll leave you – there's a lot of work to do on CMB in both geographies, but you can see the different journey depending on if it's a retail business, CMB or GB&M, in those geographies.

Ewen Stevenson

Oneof the other challenges we had with yesterday's announcement was we've got a new US CEO and CFO who literally started on the job less than four weeks ago, so they just need time to work through what they've inherited.

Tom Rayner, Numis

Can I just stick on strategy for now? And maybe we'll come back to Q3 later on, I guess. Just looking at what you put in your slides where there is too much capital, you flagged continental Europe, the UK non-ring-fenced, notably GB&M and you didn't sort of mention the US. I'm assuming the bulk of the RWA reduction we're looking for is coming from the non-ring-fenced bank. And you've helpfully given us this extra slide today which I have looked at which splits down the half-year stage into product line. If I look at GB&M, $121 billion out of what was $189 billion total in the non-ring-fenced bank – that's subsequently fallen to $182 billion, I think, at nine months. Can you give us any sense of whether that GB&M contribution to the total is still the same and, within that, how much is UK? Because that ties back to the comment about where you think too much capital is currently deployed. Thank you. And I have a second strategy-related question as well.

Ewen Stevenson

Yeah, I don't think the percentage contribution has probably changed wildly, I would have thought, over the last three months. And the bulk of that, the great bulk of that, will be UK-based.

Richard O’Connor

There's information in the data pack as well, Tom.

Tom Rayner

Yeah, but can I get the actual percentage? I know it’s probably somewhere – 80%, 90%, probably. But is there anywhere that we can get the actual number or…?

Richard O’Connor

We’ll have a look at that.

Tom Rayner

Then I think yesterday –

Ewen Stevenson

Does that fundamentally change anything?

Tom Rayner

No, it just sort of gives us a target to work with.

Ewen Stevenson

We don’t view our capital as being any different whether it’s sitting here in the UK or sitting in continental Europe. If it’s not earning a sufficient return, it’s not earning a sufficient return.

Tom Rayner

Okay, that’s fair enough. Then I think Noel mentioned in the Q&A that the focus is very much on customer profitability. I just wondered, do you think, currently, the way GB&M is managed, that maybe isn’t the case? And I'm thinking about whether you might use your balance sheet to win mandates where the total profitability, if you took everything into account, is not good enough and that things might change going forward.

Ewen Stevenson

What Noel was shorthand-ing for was, we have customer relationships both in the non-ring-fenced bank and the US where we will do the relationship lending in Europe or the US and the bulk of the fees from that customer relationship are booked elsewhere in the world, typically in Asia, so…

Tom Rayner

It’s a US-specific comment, really.

Ewen Stevenson

In some ways, we have talked in the past about the incremental return that we book in these markets elsewhere on the planet, so, you know, it is slightly misleading, looking at these returns, because there is incremental return generated, say, in Asia that would be lower if you fully – if you allocated out some of that corporate-lending drag that exists in Europe and the US.

Richard O’Connor

Can we go to Hong Kong for a couple of questions?

Yafei Tian, Citi

One question around growth. Previously in your strategy update it was around the pivot to Asia, and now the Asia growth has slowed down compared to where the plan was laid out. So just wondering, in your new planning process, besides Asia, what are the other areas where you envision that you can grow into as you reduce the less profitable RWAs?

Ewen Stevenson

I think if you look at the amount of profits we're generating out of Asia, they have only increased. If you say 'pivot to Asia' and you look at yesterday's results, both those of Hong Kong and Asia generally, I think it was something like 96% of our reported profits came out of Asia, so that feels pretty pivoted. And it was a slightly lower percentage in the 80s if you look at adjusted profits.

So, yes, the growth has slowed down. That's why I was saying earlier that the reallocated capital – I think today, if we went to Asia and said, 'Look, here are $10 billion to invest. Go for it,' they'd say, 'We'd really struggle to reinvest that amount of capital organically pretty quickly,' because the constraint in Asia isn't just the capital constraint. Often it's not a capital constraint; it's typically, can we deposit-fund the growth? Can we hire or train relationship managers to grow the business? You know, there isn't a set of acquisition opportunities that we would view as highly attractive in Asia that we'd want to spend the money inorganically either at the moment, so I suspect there'll be some incremental capital if Asia felt less constrained than what it does today, but we're not talking about the ability to rapidly redeploy billions of dollars of capital.

And in terms of elsewhere in the world, I think, we're growing about as much as we want to grow here in the UK. I think we continue to see reasonably interesting pockets of opportunity in the Middle East. Mexico is a market we like and we think we can grow. Parts of Canada we think produce attractive returns. But, again, in aggregate, I still think the capital redeployment will be dwarfed by the capital release, I suspect, in the very near term, absent inorganic.

Yafei Tian

Thank you.

Richard O'Connor

Another question from Hong Kong?

Gurpreet Sahi, Goldman Sachs

Just a question on Hong Kong trading costs. Was there an increasing probability of a downside scenario in Hong Kong? And how did that compare to how much you'd allocated as downside scenario for the UK? And then how do the trends in the macro like high-frequency data compare to and how does the management feel about fourth-quarter credit costs looking at these things?

Gavin Francis

So in Hong Kong what we did do in Q3 was basically add a management overlay to really reflect the fact that consensus, we thought, was stale. So we did our – I think it was $80 million or so in Hong Kong related to that, if you like, refreshed consensus. We didn't actually change any of the downside scenarios in the UK compared to where we actually have been since the beginning of the year.

In terms of looking forward, I don't know, Ming, if you want to talk to that from an Asian perspective.

Ming Lau

At this point, look, if you look at overall Q3 impairments for Asia I think it broadly equated to about 25 basis points in terms of loan losses. I think Ewen alluded to this yesterday. We're not seeing a significant increase at this point in terms of accounts going into worry-watch-monitor at this point, so despite kind of what's happening externally credit quality in the portfolio is still holding up at this point.

Ewen Stevenson

As I said about the macro level yesterday, based on what we can see today, we would think we'd be at the very low end of that 30-40 basis point range for the full year, which would mathematically imply credit costs not dissimilar to what we saw in Q3.

Richard O'Connor

Back to London.

Jenny Cook, Exane BNP Paribas

Can I ask a question about RWA procyclicality in Hong Kong? Because I can infer from your RWA guidance that you're reasonably confident about the RWA trajectory over the coming quarter, and if I look at the 3Q results I can't really see much RWA procyclicality coming through from Hong Kong, but a little bit from Argentina. So I just wanted to understand the sensitivity of RWA procyclicality in Hong Kong to macro changes there, because we've seen quite a significant downgrade and credit rating changes as well in Hong Kong.

And, on that, how are you thinking about pricing and loans to SMEs in the region, given the need to stimulate credit and demand there but also balance that against more RWA procyclicality in the region going forward? Thanks.

Richard O'Connor

Yeah, you're absolutely right. If you look at the RWAs and the book quality, it was up about $4.9 billion, and that was all Argentina. So you did see elsewhere stage-three loans were stable, albeit they're up a little bit when you look at the roundings in the quarter. Obviously, we're – obviously in Hong Kong we have heavily secured books and so the credit migration on those I don't think will be dramatic, but I think, as we alluded to yesterday, the area to keep an eye on will be consumer credit and small business. So I don't have a good answer for that, because clearly we're going through this over the next few quarters. I think the answer is, we'll monitor it. But the big books are secured with investment-grade, very, very prime credit quality. But there'll be pockets which we'll have to keep an eye on, and the two will be consumer credit and small businesses.

Ming, I don't know if you've got anything to add to that in terms of RWA migration.

Ming Lau

If you look at the Hong Kong situation, it's really only been in the last, you know, couple of months or quarter where the situation externally has deteriorated, right? So if you look at the overall credit-review cycle, at this point not a lot of that, I guess, credit migration and drift has come through. You have to kind of wait as the overall credit-review cycle works its way through. But nevertheless, as I mentioned previously, at this point if you look at the overall credit quality in the portfolio and the amount of accounts moving into worry-watch-monitor at this point. It's still relatively benign.

Ed Firth, KBW

Great, thanks very much. Yeah, can I bring you back to the strategy or the sort of new strategic direction? Because I guess, as analysts, these sorts of exercises are always super-exciting, because, you know, you take out a third of the assets and lose no income and profitability goes through the roof, but we have had quite a few of these programmes in the sector over the last few years – and I guess one that you were particularly close to in its early days. And when we've reached the promised land, it's generally been woefully short of where we expected when we started.

And so I just wondered, could you share with us some of your thinking about what has been the cause of that? Is it the linkages? Is it the central costs that end up getting allocated over a sort of smaller pie? And how would you try to guard against some of that as you try to reduce the size of the capital in HSBC?

Ewen Stevenson

I'm not sure what former exercise you're referring to, but I was involved in two. I was advising the Board of Credit Suisse when we started on a significant restructuring of Credit Suisse's FICC franchise. I think what you did see there was quite a significant reallocation of capital away from fixed income. So, actually, I viewed that as relatively successful. If Credit Suisse had not have done that today, they would be in a much worse shape than what they are. RBS – actually, while I was there we shifted 75% of the capital out of wholesale banking over four and a half years. I did view that as a relatively successful exercise. Again, if RBS hadn't have done that, they would have been in a pretty difficult place today. It basically saved the bank.

So, looking at the RBS exercise, you just need extreme discipline in stripping out cost. You lose all the revenue pretty quickly. You can identify direct cost pretty easy. The frontline relationship managers who are associated with that revenue or traders – you can pretty quickly identify what I call direct/indirect, so the Finance team supporting that part of the business. The bit you really have to be super-disciplined on is the indirect/indirect, because there'll be a decent portion of that cost structure getting allocated out from the centre to those revenue streams, and you need a dedicated programme of work to remove that. It's not hard; it just requires discipline. Yeah, and if you look at the numbers we sent around yesterday in the non-ring-fenced bank, for example, at the moment, you know, that capital is just not generating any return. So, almost by definition trying to take some of that capital out and having a decent whack at the costs behind it should produce better returns for the organisation.

But, where a bunch of banks in Europe have failed is because they actually haven't followed through. RBS was probably one of the few banks that actually followed through and did what it said it was going to do on return and fundamentally restructured their wholesale banking operations. So I think I haven't been involved in previous exercises here, but obviously those previous exercises left a third of the capital base in insufficient returns, so that by definition wasn't successful for the economic environment we're now operating in.

Richard O'Connor

I'll just add two other things to that. Firstly, clearly, here we're not talking about NPLs or stage-three assets; these are liquid assets, quite short-term books in the main. Obviously when you're talking about selling in small countries, those are more difficult, as we've seen in the past. But certainly for the wholesale business it's a pretty liquid balance sheet and a pretty high-quality balance sheet. It's just the returns from these units.

Ed Firth

Yeah, and I guess related to that, then, as we think about the trajectory, as a programme like this goes through, should we be expecting the revenue – I mean, should there be sort of a down before there's an up, in a sense? Because if the revenue comes off very quickly and then it takes longer to get the costs out – is that how we should be thinking about the trajectory of a programme like this over a three- or four-year period.

Ewen Stevenson

I don't think I've talked about a three- or four-year period. I would hope that you could get the bulk of this done in a couple of years. And, yeah, I don't think when you look at the asset pools associated with this, we typically have relatively short-dated asset pools. The trade book is relatively short-dated, but there will be a rolling trial of corporate lending which is typically three-year lending, which will just roll off when those relationships come up for renewal. You'll either re-price them or exit them at that point. And, again, there's no reason why the bulk of the costs shouldn't be able to come out over that period too.

I guess the other thing we haven't talked about is the fact that we did about yesterday the Group's central costs. And I think one of the other features of the Group is, post the DPA we had from Mexico in about 2011, I think a couple of things happened. We created a very large central cost structure as we shifted from a largely subsidiary-led business model to a Global Business-led model without reducing the cost structure in those subsidiaries. So we run a full head office cost structure here; we run a full head office cost structure down in Hong Kong and the US etc. And, secondly, you had the re-regulation of the banking sector going on: so, Risk, Finance, Compliance etc all staffed up, consistent with that.

What you see therefore in the Group is a very, very bloated head office structure and Group central costs that we think, again, we should be able to reduce materially. And it's not just the costs. It's also the fact that cost structure is creating a degree of governance complexity, which is just slowing down our ability to execute. Effectively, we're running subsidiary governance and Global Business governance that constantly gets in the way of each other in terms of fast execution.

Raul Sinha, JP Morgan

Maybe just staying on that theme, Where we're coming from is we've had successive management teams talking about the nature of the trade bank and the fact that, as you yourself alluded to, an asset that is booked in London will eventually be supporting a client relationship where the profitability is in Asia. I was wondering whether you had thought about quantifying for us what is the cash and revenue or sort of indirect revenue linkage to some of these RWAs. And should we think about CMB as where most of the interlink revenues are and GB&M as sort of the balance sheet-heavy localised business?

Ewen Stevenson

Well, on the latter I think it's a bit simplistic to do it that way. For example, in the US we have a number of large US financial institutions where we do a lot of their sub-custody work for them down in Asia. And so whatever relationship cost is born in the US, we book significant custody revenues down in Asia as a result of that. So I do think it's simplistic to look at GB&M versus Commercial Banking.

Typically where we have a corporate and we do business with them in multiple geographies in multiple products, there is a very profitable relationship. But, on top of that, we do a lot of other stuff. We have a large amount of domestic business. And I think what's happened over time is that the business model has got diluted. So we put a flag down in a country and we say, for example, 'The retail bank is there to fund the commercial bank,' but the retail bank starts offering mortgages and credit cards and going into full-service retail banking. The commercial bank starts doing commercial real estate lending to domestic clients and starts building up a domestic customer base. And so the real pure network international component of it has got heavily diluted by a lot of domestic business.

So I think a lot of this is about getting back to the purity of the business model and saying, you know, 'Where do we really have sustainable competitive advantage?' and executing against that, and just being ruthless about getting out of the other stuff that we've allowed ourselves to do. And if you look broadly at how we've defined the Group, we have broadly four large domestic markets: Hong Kong, UK, Mexico and the stake we have in Saudi Arabia, where we're part of the oligopoly; we're making decent returns. We have a bunch of markets that are below that which are scaled, but they're only really scaled in a retail commercial banking sense to typically 3% market share, so well below what you would consider to be scale players in those domestic markets.

And then in the network, the network has a plethora of stuff, you know? So we're the second biggest bank in Bermuda; we're the second biggest bank in Malta; we have a big bank out in Armenia. We have a set of full-scale retail commercial banks to other markets, where we're almost just a pure rep office doing international business. So when you actually go through the network and say, 'What are you doing in every single country? What are the participation choices you're taking in those countries and why?' I think there's a lot of what we do currently that we will be able to revisit and adjust. And that's really what we're sort of going through at the moment: a pretty fundamental exercise that goes beyond just the non-ring-fenced bank and the US. When you look at the biggest single impact, the biggest single impact, I think, is addressing the returns gap in the US, the non-ring-fenced bank and Group costs.

Raul Sinha

So if we were to see a review impact outside of these two that you've talked about, would you actually quantify that for us going forward?

Ewen Stevenson

Look, I do think we need to do a better job at explaining how we create value out of the international network than we do today. A typical exercise that gets done by an investor is they just look at the domestic markets and back that out and say, 'The rest of it, therefore, must just be destroying value. Why don't you just effectively shut the network down because it's not creating value for us.' There is value in there. We just haven't done a good job of explaining what part of it creates value.

Raul Sinha

Maybe just on a second topic, then, on investment, you've flagged I think in the slides as well as on the call that in Q4 there will be a step-up in investment relative to the Q3 run rate. What are you sort of thinking about the budget for next year? How does this restructuring add or change the way you were investing into any areas of the cost base?

Ewen Stevenson

Well, we're working very hard to protect the investment budget that we want to spend for next year. In some ways, had we been persisting at trying to solve for an 11% return on tangible equity or getting as close to that as possible for next year, we would have started to take very suboptimal decisions in relation to investment. So I would argue yesterday's announcement actually gives us more capacity to invest for next year, because internally we're not trying to solve for an unrealistic ROTE target at this point.

But relative to the $15 billion to $17 billion that we set out for 2018-20, we will probably end up spending something like $14 billion, maybe a bit more than that, over that period, which is really to get to 15, it's really an extra quarter of investment spend. And I think some of the stuff that we're doing – frankly we are investing in stuff today that we can probably stop investing in, depending on the decisions we take over the next couple of months, which again allows us to redirect some of that investment spend.

The other debate we're having on the investment spend is, given global growth, is it a different outlook to where we thought it was going to be relative to June last year? Do we need to shift more of the investment spend from a focus on revenue growth to productivity? So we're in the middle of that discussion at the moment.

Richard O'Connor

One or two on the left and then back to Hong Kong.

Steven Chan, Haitong Securities

Going back to SMEs in Hong Kong, I think Ming commented saying that asset quality remains quite benign, but if you look at the HKMA's recent actions, they are actually creating this so-called SME lending coordination committee. From the regulator's point of view, I suppose the situation is getting worse and worse and getting more severe. So my question is, by what size – how large a size of your SME loans do you think are going to need to be rescheduled according to the suggestion of this committee? What will be the impact of these rescheduled loans? Will that affect your net interest margin in Hong Kong? Do you think you would also need to make appropriate provisions for these SME loans, so-called rescheduled SME loans? I think the HKMA do not force the banks to do so, but, you know, if that results in some delayed delinquency for these SMEs, if the Hong Kong situation is getting worse. Are you worried that the provisions in Hong Kong are insufficient? That's the first question on Hong Kong.

The second question is on China. We have seen that the PBOC have not selected HSBC as one of the LPR-quoting banks, so did you see any change in the relationship between the Chinese government and HSBC at the moment?

Ming Lau

Let me answer the SME question in Hong Kong at this point. Look, I believe the measures taken by the government at this point are in anticipation of, if you look at the situation externally and the impact on the different sectors in Hong Kong, it's no secret if you look externally, given the fall in tourist numbers, the fall in retail sales etc, the sector that's going to be impacted the most, definitely, is SMEs. So the measures you're seeing in terms of some of these policy changes coming through are to address that in anticipation.

But, again, as I alluded to, if you look at the situation, we're only three months into the protests, right, at this point. Looking at our own portfolio, our concentration of SME lending, I would say, broadly across Hong Kong is probably no more than 15% of our overall portfolio on lending. So from that perspective I guess looking through… The risk teams are assessing proactively the impact of the deterioration in the retail and tourist sectors on our portfolio as we speak. I guess, as we go through and complete that assessment we'll be in a better position to provide some guidance as to what we expect on that, but, as I alluded to, it's still only two to three months into that at this point.

On China, on the LPR component at this point, look, it hasn't changed our stance or strategy in terms of our position in China, right? We're still committed to China as a business overall. If you look at what we've done on the retail side of the business, we continue to invest in China. We've opened a couple of new branches and locations in the insurance business in Shenzhen, for example, and we're continuing to invest in HSBC Securities. So we're taking a long-term approach in terms of our view on China at this point despite the LPR issue which you raise.

Ewen Stevenson

You should assume that people like Noel, Mark Tucker, Peter Wong, who runs the Asian business, spend an inordinate amount of time with the Chinese government talking about the relationship. I was with Mark yesterday. We get no sense that there's any issue.

Ming Lau

The other comment I would make is, you know, if you look at the growth in China this year, we're still seeing about 7-8% loan growth despite the challenges we're seeing in the macro environment in terms of the interest-rate environment in China, where we've seen a bit of compression on margins. We've still been able to deliver about 5% growth on revenue in China, and that's with pretty severe margin compression. So, broadly, on a macro basis, if you look at it, the volumes we're seeing in our China business are still holding up at this point.

Ewen Stevenson

Yeah, I think when you think about mainland China for us, it's important to keep in context that we have less than 0.2% market share. So whether the Chinese economy is growing at 5% or 7% it's not a constraint on our growth in Mainland China. Our main constraint on growth in Mainland China is our ability to get deposit funding to finance whatever growth we're able to put on.

Richard O'Connor

Any other questions from Hong Kong before we go back to London?

Mark Phin

No, not at the moment.

Christopher Manners, Barclays Capital

Morning, just a couple of follow-up questions on the two divisions that we've been highlighting for restructuring. On the US, could you just let us know a little bit about the retail franchise there? I see it's loss-making on a profit basis, about 17 billion of loans. I know that you sold, you know, a big chunk of the branch network to First Niagara historically. Is that something that, you know, could be disposed of in its entirety or is that 50% LDR they have there something that does fund the rest of that unit that you were alluded to before?

Ewen Stevenson

I don't think we've got any intention to sell our retail business in the US. I think the debate we're having is what size and shape we want to have in the retail business in the US. You know, the current plan had been to invest over a five-year turnaround of the business. We sold off the card portfolio a few years ago, which is the most profitable part of retail banking in the US, so the economics of rebuilding a card portfolio are that you have to provision very heavily up front if you don't have the history of provisioning for that card portfolio. So you're almost in loss-making until that card portfolio reaches a degree of maturity. I think that helps drive the scale of some of the losses you see here.

I think the debate we're having at the moment is that we're very good at Chinese diaspora in US, Canada and other places. We're very good at a subset of what I call internationally affluent, mobile – that tends to be very heavily concentrated in a few cities on both coasts. And so you could say that's where you do have sustainable competitive advantage, and what more than that do you need to do? But also the retail bank is also an important source of core deposits into the banking operation in the US. So, again, it partly depends on what the scale of that banking operation is and what degree of core deposits you need out of the retail bank and what the best way is to raise those core deposits too.

Christopher Manners

Could I have a follow-up on the UK non-ring-fenced bank? It's just to ask obviously you mentioned before that this business is facilitating other parts of the Group. Would it be possible to let us know roughly how many RWAs it has and how many costs it has that do facilitate revenues outside of its own sort of perimeter? Because that's something that, I guess, you wouldn't be able to take a chunk out of without us having to think about knock-on impacts to the other parts of the Group.

Ewen Stevenson

If you broadly look at GB&M, yeah, there is about $280 billion of RWAs globally, of which $120 billion sits broadly outside of the non-ring-fenced bank in the US. And I think of the remaining $160 billion, it would be a subset of that that's really supporting the rest of the $120 billion.

Christopher Manners

Thank you.

Magdalena Stoklosa, Morgan Stanley

Two questions, really. We've talked about GB&M a lot in terms of the risk-weighted assets, in terms of the capital side. But could you frame the restructuring for us more in business lines? What's strategic and what do you think is still an optionality for you? Has HSBC kept, as a lot of other wholesale banks, a couple of business lines which probably don't make sense kind of now or going forward from a business or regulatory perspective? So that's the first question.

And the second question is about the delayering of your kind of costs at the centre. Can we look at your announcement of restructuring costs in the second quarter and see it as the beginning or kind of a first salvo of that, of reducing the complexity of kind of running that centre/subsidiary Group structure?

Ewen Stevenson

On Global Banking and Markets, I think it's very much a question – it's not just a product-line question; it's also a geographic question too. So, again, if you look at the breakdown of GB&M profitability in Q3, what you see is that Asia is well under 50% of the RWAs, 50% of the revenues and well over 80% of the profits. So there, running a full-service GB&M franchise could well make sense for us, every product, every customer segment etc. When you get to Europe, the answer may be fundamentally different.

If you go through and you were to say – and it's a bit simplistic to do this and look at the returns. Typically, you'll see that the transaction businesses are relatively high-returning business, including the FX franchise. And, you know, it's the other FICC businesses – equities, advisory – outside of in the US and Europe which are producing weaker returns. And the more it's linked in to the core corporate franchise, like FX, I think, again, the returns typically are better.

But, you know, as I say, you have to be a bit careful with that analysis, because within Global Banking sits a big chunk of the corporate lending book. And, again, you're going through a debate. The Securities Services franchise – how much of that custody revenue is linked to a lending relationship to that custodian. And you will have different debates internally depending on whether you speak to the Securities Services folk or the Global Banking folk as to whether or not that revenue would be generated without the lending relationship.

On HQ, I think a relatively limited amount of what we've done, I think, would get to what we're currently now looking at.

Tom Rayner

Tom Rayner again. Feel free, everyone else. Can we focus a little bit on Q3 itself because, obviously, a lot of focus on the very difficult revenue environment and how it's all got worse, but if you sort of adjusted out all of the volatile items, I mean, the revenue didn't actually look that bad in Q3. I think it wasn't far off consensus and it was growing maybe a couple of per cent year-on-year in what we knew was a tough environment. The margin ex, again, the one-offs was down a couple of basis points. I mean, how much of this decision has been really that you're just not happy with the overall shape of the Group and profitability rather than a step change in the revenue environment. I mean, I'm wondering whether the HIBOR relationship re-establishing with dollar is worrying you about the margin maybe. I'm just trying to get a sense, because I didn't look at your revenue first thing yesterday and think, 'What a disaster.' I thought, 'There are a lot of big negative market-related items in there.'

I've got a question as well on expected credit loss. And, again, I'm not sure this number's exactly right, but it looks as if about a third or more than a third of the charge in the quarter was driven by movements from stage one to stage two, so I'd just like to get a sense if that's right, if you could add any colour on what and what you're expecting maybe going forward.

And the just finally slide 19, where you break down the corporate centre – I just wondered whether there was any guidance you could give us on some of the line items in there. Thank you.

Richard O'Connor

I'll do the second one first. Stage two was the $400 million out of $900 million and stage one was about $500 million. So that was – sorry, stage three. The stage three charges were consistent with previous quarters. So, as we said, our stage-three loans didn't move that much and our charge-offs didn't move that much. It was movement into stage two which was the increment, and about half of that was model driven and half of that was, obviously, economically driven, including Hong Kong, as you heard earlier.

So obviously you can identify the moving parts to at least try to model future quarters. It's difficult for us as well, because it's the first time we've gone through this, and IFRS9 is inherently volatile quarter-by-quarter. So I don't think we've given you false comforts. We've given you all the disclosures and the tables, which can at least give you the building blocks to look at that.

Ewen Stevenson

Look, on Q3 I don't think I ever described the revenues as disastrous or whatever word you were using, Tom. Look, I think in terms of those headline results we announced yesterday, the reality is that they were disappointing at a headline level, but I think when you unpick them things like Argentina, the insurance manufacturing, the UK were driven largely by one-offs. In the US and Europe, there’s nothing fundamentally new there. In terms of the non-ring-fenced bank and the US, they’ve been making weak returns and those weak returns continue.

I thought most parts of the franchise held up pretty well. Global Markets did have a weak quarter, and I think that partly that reflected a very strong comparator relative to others that we had in Q3 last year. Partly it reflected the geographic bias of the business. We’re not big in the US, so I think a lot of the US banks – I think Barclays and others benefited, those who had significant US presence. We didn’t. So that was probably the only part of the Bank that sort of significantly underperformed relative to what our expectations would have been.

Yesterday’s announcement in terms of the changed outlook – I think that changed outlook only really triggered the statement around the 11% return on tangible equity for 2020. It was just not realistic, I think, for us to continue to defend that target and I think fundamentally consensus had been there for some time anyway at setting just below 10% ROTE for next year. We're a very interest rate-sensitive stock, and that change in interest-rate outlook just fundamentally changed the profitability outlook for 2020.

But I think all that together just drives a greater degree of urgency and execution, because, fundamentally the distribution policy of the Bank requires a higher return. So we've been solving for that sustainability of distribution policy over the last few years by actively managing RWAs whether that is through model improvements, taking underperforming RWAs off the balance sheet or recycling low-returning RWAs. There's obviously a finite life to that at some point, so fundamentally we need to get the returns up in the Bank, and it’s difficult to get the returns up in the Bank if you've got a third of your capital earning a 1% return. So it’s all kind of circular at some point.

So that puts urgency into needing to restructure that third of our capital to get our returns up, which allows us to sustain the distribution policy of the Bank over the medium term and to grow into areas. We've been operating under constraints which have been frankly… You know, parts of Asia have asked for more capital and parts of Mexico, and we said, ‘No, you can't have the capital, because we’re RWA-constrained.’ You know, that felt wrong to us from a business perspective.

Richard O’Connor

On Group centre, I've got good news and bad news. The good news is, going forward, when we report this, it’ll be much closer to zero. The bad news is there's a re-statement coming probably just after the full-year results, as we allocate this out to the businesses and segments more than we do currently.

If you look at the individual line items on slide 19, balance-sheet management had a good quarter, $626 million. There were some gains in there, about another 60 in incremental gains. So we're shooting towards, you know, the lower end of $2.3 billion, $,2.5 billion for the year. Interest expense, $321 million, I expect that to continue to nudge up as you get more MREL issuance. Valuation differences positive $76 million– that trends to zero. Other central treasury, that’s unallocated to other treasury stuff, is normally about $60million. Legacy credit continues for a bit, but should trend to zero, and then the other, obviously that was distorted by the Argentina hyperinflation and then some revaluation or devaluation of properties. So, again, that can be quite volatile but tends to be negative but less negative than the $367million, if you strip out the hyperinflation and the $80 million revaluation of property loss. So if you take that you should get a good run of it.

Tom Rayner

When's the restatement?

Richard O'Connor

Just after – at the moment, just after the full-year results. So we won't ask you to remodel before the full year, but clearly.

Gavin Francis

So there will be restatement of global business results from a comparative perspective, with effect from 1 January 2020, I think is the plan.

Ewen Stevenson

Yes, so we're not just sort of restating it because we've decided to restate. I mean, fundamental to this is trying to allocate out corporate centre to get better views on underlying divisional returns – business line returns. There will still be quite a sizable amount of corporate centre, because remember we still have two very large stakes, for example, the BoCom stake and the Saudi stake that sit in there. I think balance sheet management RWAs will continue to sit in there, so there'll still be a large capital allocation, but the returns drag should be closer to zero, I think.

Joseph Dickerson, Jefferies

It's Joe Dickerson from Jefferies. I guess, coming back to the dividend point, is the 51 cents dividend sacrosanct, and if so why? Because it seems like it is posing quite a constraint on the overall business from the standpoint of making capital allocation decisions. We just saw Nordea – whether you believe their strategy or not – they cut their dividend 20% to fund some restructuring, cost reduction, and the investor response has been fairly favourable to that in the aftermath. So, if it's sacrosanct, why is it so sacrosanct?

Ewen Stevenson

Well, I don't think I've ever used the word 'sacrosanct'. Equally, we seem to have caused some confusion yesterday. Please do not read into the subtlety of our dividend language yesterday as suggesting any change in relation to intentions on dividends. It was supposed to say exactly the same thing, so apologies if we slightly reworded it.

I mean in my view is that our investors would not thank us if we continued to say, 'Look, we're cutting the dividend in order to protect a third of our capital not earning any return.' That, to us, feels like a poor investor meeting, to me.

And the reality is that that dividend today has led to a set of investors that are invested in us, who are very income-focused. So, yeah, it's not sacrosanct, but there's a very high bar internally to adjusting that dividend policy, and if we came up with a revised strategy and that revised strategy said this should be the right number then we'll have that debate but, I mean, we've got no current intention to change our approach on dividends.

Richard O'Connor

Anything else? Oh, sorry Ian, and then last – anything else from Hong Kong before we close up.

Ian Gordon, Investec Securities

Ian Gordon, Investec. Just two, please, on the restructuring. I know you haven't guided yet on the quantum of one-off restructuring costs, but is there anything you can say in terms of what the property component might be? I always struggle to envisage the scale of property-related costs. They're normally much higher than I expect.

And then, secondly, you've guided to a potentially significant charge in Q4. Again, another naïve question: that's earlier than I would have expected. Even if it was relating to severance, I was assuming the costs wouldn't really hit until next year. So what type of significant costs are coming down the road in two months' time?

Ewen Stevenson

Well, it's not two; it's three and a half, but there's no guidance on property costs. I mean, some of it I think depends on which buildings and when. For example, Champs-Élysées headquarters, which is in the public domain, it so happens that the lease on that is coming up for renewal, so we will be able to exit that property relatively cheaply. There may be other properties that we come to review that we want to exit, potentially. Depending on where we are in those lease contracts, it could be significant, but we haven't done that work yet.

You're right: in terms of severance costs, we can only book severance costs when we have developed plans. You know, we've still got time to develop those plans between now and the end of the year, but I don't – I think the main thing to focus on, you know, if you look in the annual report and accounts, we have about $6 billion of goodwill sitting across CMB and RBWM for Europe. We also have $4 billion of goodwill sitting against Global Banking and Markets globally, and $3 billion of goodwill elsewhere, including, for example, about $400 million of goodwill sitting against our US private banking business. So there are pockets of goodwill sitting everywhere, and I think all we're trying to signal is, as we work through the work that we've telegraphed yesterday, there may well be some need to revisit some of that goodwill, but we haven't done the analysis yet to have a view.

I think the other thing we were being cautious about yesterday is we still want the capacity to go out and issue debt for the next few months, so we did not want to put ourselves into a disclosure hole, where we would come out and announce a bunch of stuff in mid-February and debt investors would turn around and say, 'You gave no inkling of any of this stuff.'

The other constraint, I think, to acknowledge on taking a very large restructuring charge in Q4 is, going back to the comment on capital, if we're working towards keeping our core tier-1 ratio above 14%, there's a natural constraint on how much restructuring charge we can take into Q4, because that will have an impact on our capital ratios. So I suspect a decent amount will also flow through to 2020.

Richard O'Connor

Any last word from Hong Kong?

Mark Phin

I've got one from Yafei.

Yafei Tian

Yes, Yafei from Citi again. The question is around maybe the bigger picture of the future of European investment banking. Quite a lot of European banks have exited particularly the FICC space. I just wonder, from HSBC's perspective, what's your market share like in some of the larger segments, like FX, rates and credit? And, looking at some of the core competitive advantage that you have in retaining maybe part of those businesses in this restructuring process, and whether you have quantified what could be the number of FTEs attached to these businesses that could be restructured.

Ewen Stevenson

We're not going to come out with FTE numbers, because they tend to get played up very heavily in the press. Just in context the *Financial Times* number was not a number that was sourced from us. That was a number that they created and has since gone viral as a number of headcount reduction that we're looking at. So, I mean, I'm sure you can all appreciate that we're not going to talk about headcount numbers until we've actually talked internally to our people, because it just creates havoc internally.

The one FICC business where I think we have, you know, a sort of world-class franchise is FX. You know, it's top three. About 50% of the revenues are linked to the corporate franchise. It's a very sustainable and very strong franchise. I think if you look across all the other business lines in FICC in Europe – Equities, Advisory etc – they're not distinguished, in terms of market shares. The one – if you were to compare European market shares with Asia, you would see in most areas we're top five in Asia. In most areas in Europe we're not top five.

Having said that, even if you were top five in Europe, I think most European, US, whoever's doing investment banking here, struggles to make acceptable returns, and most people are cross-subsidising their European investment banking businesses with returns made elsewhere. So, with a bunch of people working for competitive banks here in Europe – and, I mean, I used to co-head an investment banking franchise, advisory franchise, in Europe about six or seven years ago, so I understand the return dynamics of that organisation. They weren't vastly dissimilar to our own return dynamics at the same time – at the current time. So there's a structural lack of profitability in European investment banking.

Richard O'Connor

I think we'll wrap up for Ewen's last words. We had a couple of questions on what you call connectivity outbound revenues around the group, and would those be impacted by the restructuring? Clearly we'll do our best not to. Our best relationships are where we have cross-border connectivity. That what we call connectivity revenues has grown by the mid-teens in the last few years, as we've broken the back of the DPA. We need to do more of that across the group and that will improve the group return, so whilst, if you are downplaying or exiting corporate relationships in the US or Europe, it may impact revenues elsewhere in the group, we'll do our utmost to avoid that, obviously, as we go through and it's an area – it's been our focus in Commercial Banking and GB&M for the last few years, and it's been a successful area for us, so that's something we're conscious we need to defend. Ewen, any last remarks?

Ewen Stevenson

So, look, our view is what we announce tomorrow should be very investor-friendly, so the main discussion point, actually, we've had with investors, the media and others is why is this time any different to any other time? Not that anyone's actually fundamentally questioned what we announced yesterday. It's just, are we going to do it, I think seemed to be the main question.

You know, we have some remarkably strong franchises around the world that are being dragged down by a bunch of our capital sitting in businesses not earning a high enough return. I would say the Board is very aligned. You know, it's a big part of why they brought me into the bank. There was a frustration that the management team wasn't executing against a clear direction of travel. I think Noel perfectly understands that dynamic and so I do think it is different this time. And, you know, I think if we come out with a disappointing announcement in February, we understand that that would not be well received by the market. So in some ways we've kind of front-run the need to come out with a very positive set of announcements in February, which you should also think about too, right? That carries a high degree of management risk if we don't deliver against that.

Thanks all for your time.