CARLO PELLERANI: Good afternoon everyone. This is Carlo. I’m joined today by two individuals that need no introduction: Richard O’Connor, Global Head of Investor Relations, and Greg Case, Head of Debt Investor Relations. I’m not going to go through the slides that we posted nor going to give a very long speech. I’ll limit myself to making a few highlights about the results and then I’ll go through into a bit more detail on the financial resources and then pretty quickly go into Q&A. In terms of the highlights for the result, 8.3% return on tangible, quite helped by the release of ECL provisions, but we have some very good earnings diversification with all the regions being profitable. Revenues grew by 2% in the quarter and we have given the rate environment more confidence on a positive NII trend, and you will have seen that we have announced that we are now flagging a 10% return on tangible for 2023 onwards, one year earlier than previously planned.

In terms of balance sheet dynamics, we had $38 billion of loan growth across Wealth and Personal Banking and commercial banking and, as well, we had $24 billion of growth in deposits for the quarter. Our credit quality remains good. We had low stage three charges and you would have seen that our stage three loans represent about 1.8% of the total loans and they have been stable at that level. We have now released about 85% of the Covid reserves that we had put on during 2020 and we have $600 million of those still remaining. We are expecting our ECL charges to normalise somewhere around the 30 basis points during 2022. You will have seen that we took some charges on China CRE and we have given you some slides in the document and some more information where you can see our exposure and details around those.

Turning to financial resources, taking each of them in turn, first from a capital perspective, our capital ratios continue to be quite strong. 15.8% CET1 ratio at the end of the year, dividends of 25 cents and we have announced a new $1 billion buyback on top of the up to $2 billion that we had announced in the last quarter. As a reminder, we have flagged that we are planning to be back within our target range of 14-14.5% CET1 ratio from this year onwards.

From a liquidity perspective, liquidity continues to be super strong. LCR of 138%, but that of course masks the surplus liquidity we have in all the subsidiaries, which gets deducted from the HQLA ratio, so if you were to take into account that, the total HQLA ratio that we have as a group is $880 billion. We continue to pursue initiatives to increase the returns and the efficiency of the excess liquidity in addition to our desire to increase our customer lending book.

MREL ratio, very, very healthy at the end of the year. Please note that our requirements have actually gone down by 170 basis points on the back of the UK leverage computations, which affect both the leverage base requirement, but also the sum of the parts given that a lot of the entities are leverage constrained from an MREL perspective.

From a funding perspective, we have been until now in a building-out phase of our MREL stack. We have ended that phase and we are now getting into a refinancing and rebalancing mode of the stack, so we should be expecting pretty much zero net Senior HoldCo issuance for the year. We are flagging about $10 billion from a gross perspective. We aren’t likely to be in the market for AT1 this year. We don’t quite have much of a need. Of course we reserve the right to be in the market should we think that’s appropriate.
We are conversely planning to return to the tier two market. We have been absent from the market for about five years and you will have seen that we are saying that we are planning to have around $4 billion of issuance for the year and we have added some disclosures in terms of our legacy capital stack and some update on our position on IBOR.

That’s all I wanted to say. So, in summary, a very strong year. Return targets have been brought forward by about a year. Improved rate environment which gives you a nice tailwind. Capital, funding and liquidity positions are all very, very strong. Net issuance substantially down on prior years and our MREL stack now at a steady state. So with that very brief introduction, I’ll open up for questions.

LEE STREET, CITIGROUP: Hello. Thanks for taking – thanks for doing the call and thanks for taking my questions. So I have three for you. Firstly, just on the slide 21, the fixed income slides, we’ve had a fair few questions about how the infection risk works that you highlight there. To me it doesn’t look like there’s anything new, but could you just clarify exactly how that works?

Secondly, as you highlighted, you’re returning to the tier two market. I think you flagged about $4 billion of issuance. Obviously you’ve got a significant volume of operating company tier two still outstanding. A lot of that isn’t going to work any longer. I guess the question is: why wouldn’t you look to do some form of liability management?

And then, finally, on additional tier one, you highlight limited needs. Just any thoughts around that, because obviously it looks like you’ve got quite a few bonds coming up to call over the forthcoming year and why you need to be quite so limited? They would be my three questions. Thank you.

CARLO PELLERANI: Thanks very much for the questions, Lee. So, on the first one on infection risk, infection risk can be mitigated when we voluntarily de-recognise the securities. So you would have seen that this is kind of the plan that we have for each of the components of the stack, so we don’t think that that poses any issue at the moment that each of the securities lose eligibility.

In terms of tier two, yes, you’re right, we have a number of tier two outstanding that have lost some value and some of those that will lose value in the future. Liability management is always one of the potential options that we have. We will look at each of those in turn. We will continue to look at all options available.

In terms of AT1, yes, you should, for now, assume and that’s what we have in the plan, that we will let those transactions to come and we will not be replacing them, so we have no plan at the moment to replace those AT1 for this year. Again, depending on market conditions, we may want to get ahead of next year or future years.

LEE STREET: Sorry, just to clarify, you’ve no plans to replace them or you will only look to replace them? Sorry, I’m not sure I understood.

CARLO PELLERANI: Yeah, we have no plans for issuing any AT1 this year.

LEE STREET: Okay. Can I read anything into that in terms of your intention with regards of the calls that are coming up?

CARLO PELLERANI: No, you shouldn’t.

LEE STREET: Alright, I’ll leave it there. Thank you for your time.

DANIEL DAVID, AUTONOMOUS RESEARCH: Thanks for the call and taking my questions. I also want to focus on the legacy area because there’s quite a lot of interest there. Just focusing on the legacy tier one and noting your comments, I can see that they’re not MREL or capital. Can you just help me with the rationale for leaving these bonds outstanding, given the CET1 headroom you’ve got and what they’re costing you? And are these bonds swapped? So could they – could the interest rate be hedged when you come to do – potentially do a May call?
The second question I have just goes back to your point on de-recognition from an infection risk point of view. I had understood that EBA guidance is quite clear that you can’t do this unless you call, change terms or LME to mitigate the infection risk. So my question is: is the UK’s approach different to the EBA’s? Has the PRA, I guess, rolled over and let you take this treatment? I’m just a bit surprised to read this.

And then, finally, just on the resolvability assessment framework, can you just help us to understand the timeline? So have you submitted all your information? When do you expect the results and do you expect to be told the PRA stance before the public disclosure in June? Thanks.

CARLO PELLERANI: Thanks, Daniel. On the legacy securities, so when we’re assessing the legacy securities that are outstanding, we always look at, if you want, three different components, and the blended result of those three components drives whether we will be making any – taking any action on those securities. Those components are first of all the regulatory requirement. We are in ongoing discussions with the regulators around those. Maybe we’ll get more information around midyear about those, but it’s fair to say that the regulatory treatment of the legacy securities is not black and white. I mean, there are shades of grey there in all sorts of securities. I would note that some securities are particularly challenging and that includes near loss securities where, as you know, even if we wanted, it would be impossible to pretty much eliminate a full stack. So the point I’m trying to make is this is not black and white. Obviously, from a regulatory perspective it would be better for those securities to not be there, but given the complications and all the different components, I think the regulatory treatment tends to be a little bit greyer than that.

The second component is of course yours and investors’ interest. We are a long-term issuer in the market and we want to have a long-term constructive relationship with investors and, as such, we will take those interests in mind.

But finally, and very, very importantly, we look at the economics of those securities, and the economics of those securities, as an outsider, outside from the firm, is not totally straightforward for you to see how those economics play out because you need to look at the accounting treatment that we have for those securities internally. We need to look indeed as to whether we have those securities hedged, or unhedged from an interest rate perspective. We need to look at what is the optionality value of those securities for future funding, like for example we have at the moment in the case of the DISCOs. So there is all sorts of economic components, that affect whether those securities are or not in our interest, to be called. I’ll leave it at that but that’s basically drives whether we would or not call some of those securities. In terms of hedging, we’re not going to comment on individual hedging, on individual securities, but, likewise, we shouldn’t assume that we have hedged them all.

In terms of de-recognition, I think you pretty much – you answered it in your question. It is the UK rather than then the EBA approach. From a UK perspective, we can deal with that by voluntarily de-recognising the securities. That is an acceptable way of dealing with infection risk in the UK.

And in terms of the rough timeline, we submitted our self-assessment last year. We have been in contact with the Bank of England and PRA. They have sent a number of questions, on the back of those we actually sent an update to that a couple of weeks ago in line with everyone else in the market, and the next step of the process is midyear, just in June, there is going to be a public disclosure made by both the Bank of England and ourselves on the status of that assessment. I guess we’ll have to wait for that one. Obviously we will have discussions with them ahead of that in terms of what is it that we’re going to be disclosing, and we’ll be aligning communication.

DANIEL DAVID: Thanks for that. Can I just double-check, on the voluntary de-recognition point, on the slide, you say ‘subject to regulatory approval’, so has this been approved or is it waiting to be approved?

CARLO PELLERANI: It is part of the discussion on the self-assessments and on the rest, and you’ll see, I guess, the effect of that, middle of the year.

DANIEL DAVID: Okay, alright. Thanks.
And then, two other questions. One, you made a large provision for real estate in China. Could you talk about the Hong Kong real estate market and if there’s going to be any need for provisions there given the economic slowdown and the moves we’ve seen of personnel out of Hong Kong? And then, third, on UK mortgages, swap rates moving much faster than you could probably reprice mortgages, so could you talk about the impact on your margin for the next couple of quarters on that? Thanks.

CARLO PELLERANI: Yeah. Thanks, Robert. So, in terms of the DISCOs, they de facto become senior debt, and that is senior debt that is actually not that expensive. So the DISCOs are LIBOR plus 10 to LIBOR plus 25 perpetual funding. So we looked at them in the context of, you know, funding value. Most of the DISCOs are issued out of a non-ringfenced bank, which is an entity which is naturally in funding need long term, so having that optionality is actually quite valuable, so that is how we look at the DISCOs. In terms of China CRE, yes, I think the segment of the China CRE that is most impacted is the offshore segment. We have exposures to that segment in Hong Kong. We have about 11.6 billion of exposure there. About half of that book is in what we call ‘enhanced monitoring mode’. The other half is investment grade and better. So there is always a chance that we get, you know, more impact. At this stage we have reserved what we think is appropriate for where we are. I just note that we have mentioned that we are expecting that we would be returning to around a normalised 30 basis points of provisions for the year. That 30 basis points include as well any foreseeable impact that we can at this stage see on the CRE market. Having said that, of course the situation is fluid and we will continue to look at it. If you were to look at developments this year, there seems to be a little bit more support for the China CRE market coming in terms of commentary and some of the dynamics in the market, but, again, trying to predict that ahead is treacherous, so I think we will have to see how that develops.

RICHARD O’CONNOR: Could I just add one thing? Clearly, the property companies you’ve read about, about having liquidity and other issues, are mainland China property companies [much of which, as Carlo said, the exposure is booked offshore. The question was very much more, I think, about Hong Kong incorporated public companies who have been – we’ve had a very strong relationship with for decades. Tend to be very well-resourced, very conservative LTVs, the Hong Kong property market has been very, very resilient and indeed still very, very good prices for clearing in both commercial and residential property market in Hong Kong, so clearly we keep an eye on all our portfolios, but the issue is really at that mainland China offshore market at the moment.

CARLO PELLERANI: And in terms of UK mortgage pricing, yes, your observation is right. The swap – I mean, a lot of the mortgages in the UK, of course, are fixed, and the dynamics of the swap markets are slightly different to the dynamics on the short end, so yes, it is quite possible that that market will continue to have a little bit of competitive pressure. It is a very, very competitively priced market. We continue to originate new mortgages at returns that are higher than our cost of capital. So at the moment we are comfortable with those mortgages, even at the compressed spread, but of course it is something that we will keep an eye on. I don’t know, Richard, if you want to add anything.

RICHARD O’CONNOR: Yeah, the other thing is, clearly, the market tends to look at mortgage prices in the newspapers today versus swap rates today, but clearly there’s a lag between swap rates either moving up or down and companies themselves moving mortgage prices. We don’t move it every day. Clearly we move it on a regular basis, but there’s always a lag between mortgage pricing going up and down versus swap rates, so just bear it in mind that swap rates have moved and interest rates have moved dramatically in the last six weeks, but just bear in mind there’s normally a lag there before mortgage pricing starts to reflect that.

ROBERT SMALLEY: Thanks. That’s very helpful. Appreciate it.

ALVARO RUIZ, MORGAN STANLEY: Thank you very much for taking my questions, and apologies because I have three questions, and all of them about legacy. And the first one is about HSBC 5.844, and if I follow what you just said, that there are three angles to LME or to
exercise the make whole call of this security, you are looking at regulatory requirements, investor interest and accounting treatment. I think it’s quite clear that the security is useless from a capital perspective it’s issued from an SPV and with all the detail that you already said in the pillar three. Then if you can provide some colour on this activity, that will be great. The second one is about tier two more broadly. You said that you are going to issue tier two for the first time this year. In order to LME the OpCo tier two securities, do you need to issue first? In other words, the approval to LME the securities is subject to replace other tier two securities, assuming from obviously from the holding company.

And my third question is about the DISCOs. I think we discussed this point in the past, but one of the DISCOs is issued from the Hong Kong subsidiary. Can you please confirm that you look at this security in a different way to the other three? Thank you.

CARLO PELLERANI: Thank you, Alvaro, despite the questions are all on legacy. The first – your first question, I think, is on the non-ringfenced bank trust-preferred security. Yes, you have identified correctly, I think, one of the three conditions, the regulatory treatment. I mean, we haven’t called the securities, so that must mean the other conditions kind of affect why we haven’t made a decision.

ALVARO RUIZ: But sorry, which condition? Investor interest, I mean, or accounting treatment?

CARLO PELLERANI: It must be also the economics.

ALVARO RUIZ: It’s not economical to exercise the make whole call of these securities, is what you’re saying?

CARLO PELLERANI: That could be one of the conclusions. Overall, we haven’t made a decision to call them because, on balance, that doesn’t work for us at this stage. We will continue to look at it.

ALVARO RUIZ: Okay.

CARLO PELLERANI: So in terms of the tier twos, no, I think the – we don’t have a specific requirement on the tier two stack, right. We have a capacity to have tier two in our stack up to a certain amount that, at the moment, we have on the way, right. So it is not a precondition for – one is not a precondition to the other, so we will continue to look at all the options for tier two. That could include LMEs, exchanges, it could be issuances. We will look at all of the above.

In terms of DISCOs, yes, I think the only similarity between the Hong Kong securities and the ones who are non-ringfenced is the type of instruments. The two are very different because the legal entities have very different needs. You could say that our Hong Kong entity is less of a natural funding need entity than the non-ringfenced bank, and also from a regulatory perspective the Hong Kong DISCOs are no longer counting from a regulatory perspective, so we don’t treat them the same. We would make those decisions individually in each of the entities.

ALVARO RUIZ: Okay, thank you very much, and apologies again because these legacy questions are always horrible.

CARLO PELLERANI: Thank you, Alvaro.

TOM JENKINS, JEFFERIES: Hello. Sorry and thanks very much. I don’t want to keep you very much longer and guess what? It’s on legacies, which you should be very proud of, because it means no one’s concerned about anything fundamental or anything else, so it’s actually quite a good thing that we focus on these sort of - - of these securities. But I’ve got one question which I don’t know if I missed earlier. I only heard Lee on the first one, who’s normally the first question, so I don’t think I missed anything, but LIBOR. I know you put a slide in there – I think slide 22 on the slide deck. How are you thinking in terms of your fallback language on the DISCOs? It’s really not clear. It talks about lowest deposit rate as a base of the fallback of LIBOR. SOFR is not based on deposits, so I was just wondering what you’re thinking in terms of whether you fix, whether you’ve got an alternative, is there an
alternative that I don’t know about? I’m sure there is. Just talk to me a little bit about your fallback language on the DISCOs, if you may. Thank you.

CARLO PELLERANI: Hi, Tom. Thanks for the question. Yes, so Sterling New York law instruments, for those the US legislative solution doesn’t quite work. Of course, the conundrum with those securities, for all the near low securities, is that we will not be able to successfully consent for 100% of the securities given the dynamics of the New York law. So we are looking at the options with those securities. I mean just –

TOM JENKINS: Sorry. I think we talked – I don’t want to waste your time. We’re talking at cross purposes. I was thinking of the DISCOs under English law and what the transference would be into LIBOR.

CARLO PELLERANI: Apologies.

TOM JENKINS: No, no. Please don’t apologise. I obviously wasn’t clear.

CARLO PELLERANI: Yes, in terms of those securities, we are looking to offer similar consent solicitation as we did with all the other securities. We’ll come with those in due course. I mean, those securities, we have time until 2023 for them.

TOM JENKINS: Sure, but do you think, based on the language in the documentation that you can use SOFR and then maybe upscale the coupons as compensation as you did with the, you know, the sterling LIBOR bonds, or would you use a different base rate? I mean, because it doesn’t – I can’t square the circle in terms of what the language in the bond says about the lowest deposit rate and what, you know, you’re talking about in terms of offering a new – what the lowest deposit rate sort of replacement would be, if it’s not SOFR, because it’s not a deposit rate, it’s a treasury rate.

CARLO PELLERANI: Yeah, the fallbacks on those securities are questionable at this stage, yeah.

TOM JENKINS: Okay. Would you consider fixing or would you consider just getting rid of the damn things and stopping these irritating questions from people like me?

CARLO PELLERANI: It is tempting. It is definitely tempting. Listen, we will leave our options open at this stage. I mean, overall, we are committed in seeking to remediate or mitigate anything around IBOR and we are going to work together with investors to find a solution that works for everyone, and this is a complex space, highlighted by the call.

TOM JENKINS: Right, okay. So there’s no firm answer. There’s no guidance. It’s just, ‘Let’s hope for the best and hope not for the worst’. Is that the kind of thing…?

CARLO PELLERANI: I think it’s more than that, right. In terms of the English law securities, including the DISCOs, we expect to offer a similar consent solicitation as the one we did for US LIBOR securities. I think that’s the best I can say at this stage.

TOM JENKINS: Okay. Alright. Well, as and when you know what the possible base might be, do please let the market know. We’d be, I’m sure, very appreciative.

CARLO PELLERANI: Thank you.

TOM JENKINS: Thanks very much.

CARLO PELLERANI: Okay, so thank you very much for the call and for the interest in legacy securities in particular. I hope that the call was helpful for you. If you have any more questions, please pick it up with Greg and the IR team and we will endeavour to answer, especially if they’re not around legacy securities, so thank you very much.