CARLO PELLERANI, GROUP TREASURER: Hello, everyone. Welcome to the HSBC Fixed Income Call for our Full Year 2022 results, thank you for joining us. I'm Carlo Pellerani, Group Treasurer, and I'm joined by Richard O'Connor, Global Head of Investor Relations, and Greg Case, Head of Debt Investor Relations. As usual, I will mention a couple of things on the results, then a quick update on financial resources, and finally we will go into Q&A. I will not be referencing any slides as we go through.

In terms of results I would like to mention three points. 9.9% ROTE for the year, up 1.6% on the back of higher NII and good cost controls, which more than offset a higher ECL charge. We expect ROTE to grow to above 12% this year. Second, in terms of balance sheet dynamics, the reported loans and deposit numbers need to be read carefully because they include adjustments for the Canadian and French sales and FX. If you include those, loans decreased by $25 billion only in the quarter, and deposits were flat.

Finally, credit quality remains quite solid. Full-year ECL charge equivalent to 35 basis points of gross loans. Stage 3 loans remain low, at 2.1% of total loans. At this stage we still see limited signs of deterioration in the loan book, and we’re flagging an ECL charge of around 40 basis points for this year.

Now onto financial resources. Starting with capital, our CET1 ratio, as you saw, was 14.2%, which is 80 basis points up in the fourth quarter thanks to profits and lower adjusted RWAs. We are now inside our CET1 target of 14% to 14.5%, and 3.3 percentage points above our MDA requirements.

Second, on liquidity, it remains strong, most importantly at the legal entity level. We also reported a 132% group LCR, with total gross HQLA of over $800 billion. Our loan-to-deposit ratio is quite low, at 59%, and hence we have a meaningful deposit surplus which positions us quite well in this higher-rate environment.

Our MREL ratio is 30.1%, which compares very favourably to our 26.4% requirement and we intend to continue to operate with a prudent buffer over our minimum. From a funding perspective we expect to issue a similar amount of gross debt to what we issued last year, targeting $17 billion to $20 billion of holdco senior, $4-5 billion in tier 2s, and about $2 billion in AT1s.

On legacy capital, good progress in 2022. We reduced the stack by over $4 billion. We will continue to monitor the market for cost-effective options to manage this stack down over time.

In summary, a good year. The Group is now becoming very capital generative. Our capital funding and liquidity positions leave us well placed to continue growing, and we believe our business model offers bondholders one of the most diverse sets of revenue streams in Global Banking. On that note, let’s open the call for Q&A. I’ll hand over to Greg.
GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: Thanks, Carlo. Hi, everyone. As we did last time, we’ll be taking questions over Zoom. If you want to ask a question, please can you raise your hand to signal that you want to ask a question. You’ll need to ensure your line is not muted when we come to you. I’ll just give everyone a minute to signal for questions, and you can also ask a question via the chat function.

The first question comes from Lee Street from Citi. Lee, your line should be open. Lee, we can’t hear you. Sorry. Shall we move on to Dan David from Autonomous?

DANIEL DAVID, AUTONOMOUS RESEARCH: Afternoon all, hope you can hear me. Congratulations on the results. Thanks for taking my questions. I have three. I just wanted to touch upon the AT1 call, the dollar 6.25%. Was this decision taken on an economic basis? You mentioned before the call that the market wasn’t pricing in the risk of extension, and I guess if I look at your spreads today and also your issuance plan versus your total calls this year it suggests that it could have been called outright, similar to what you’ve done in previous years.

On the legacy, could you just remind us of your priorities and whether anything’s changed there?

Just focusing on the make wholes, you’ve talked about economics there in the past as well. I’m just wondering if you can guide us to what sort of P&L or CET1 impact you’d be willing to book. I guess I’m looking at the exercises that you’ve done so far, and thinking of one to two points that you’ve paid. Is that reasonable, or should we expect that you’d maybe take a larger hit as a result of the need to get rid of these securities?

Finally, just a quick one on LIBOR. Do you intend to use the synthetic extension on your dollar discos post June 2023?

CARLO PELLERANI: Thanks very much for the three questions. On the AT1 call to start, yes, the decisions that we make are on economic terms. Now, the way that those economics are calculated are a little bit more complex than just calculating the PV of the transaction. Broadly speaking, what we do is we take into account three components. One is the PV of a call versus automatically reissuing the full amount. Second, what is the full amount that we need outstanding, and whether we’re going to have a period of time or an amount outstanding to replace that call which is smaller, and as a consequence there is a cost of carry that we are avoiding. Third, it was, ‘what is the impact on the future spreads and the issuance markets?’ When you put all those things into account it’s a little bit of an art rather than a full science. We put all those things together and we come up with the results. You saw on the back of that that we decided to call the transaction. That’s probably all I can say on that one.

In terms of legacy, you might remember from previous calls that I described that I think of these in two dimensions. There is a dimension which is how complex the securities are from a resolution perspective, and the second dimension is, ‘what is the cost of taking those securities out?’ When you put those two dimensions together we ended up with a pecking order that has, broadly speaking, four buckets.

The first bucket is the holding company Tier 2 securities. Those are in the first bucket because they’re out of our resolution entity, the holding company, and there is a lack of contractual rights of recognition of the Bank of England bail-in rights, so those are the first priorities.

Second, we have the non-ringfenced bank fixed rate Tier 2s, then we have the discos and then we have everything else. As you saw, we progressed along the first two buckets last year, and those buckets continue to be the most important and we’ll progress down from that priority list.

A third on synthetic LIBOR. All I would say is at this stage the consultation of synthetic LIBOR hasn’t concluded, so we’ll have to wait for that before we can do anything about it.
GREG CASE: We have some questions in from Lee. I’ll just read them out, because I think he’s having some trouble joining. Firstly he asks a high-level question. With all the changes in the business model in recent years, which banks do we regard as our main peers? Additionally, what’s the plan for the $4.3 billion of legacy that loses capital value in 2025, and also linked to that should we assume the $4-5 billion of Tier 2 would be a normal run rate over the next few years?

CARLO PELLERANI: Thanks very much, Lee. On the first question, HSBC stands pretty much on its own in the type of business model that we have, so we don’t quite see ourselves having a very comparable peer around the globe. What we do is we look at each of those markets and we compare ourselves versus more local peers with, of course, the caveat that the value of our franchise is actually the international connectivity. It’s difficult, pretty much, to give you a few set of peers that you can compare us against.

In terms of the legacy securities losing value in 2025, what we’re doing is we are pre-funding those amounts over the next few years to avoid a big cliff risk in 2025, and that’s incorporated into the four billion to five billion that we are flagging for this year for Tier 2.

And then on your third question, looking forward – and I would say this more broadly across all the components of the stack – we are now more or less at a level where the distribution of the different components of the stack are pretty much where we think they should be, and from this point we are about refinancing and financing growth. If you take the current amount outstanding and you divide them in a five-to-seven-year average maturity you end up with an annual amount of issuance which is not that similar to what we are doing this year. That includes also the Tier 2, so somewhere between 3-5 billion on a stable basis every year. Richard, do you want to comment on anything else, especially on the first question?

RICHARD O’CONNOR, GLOBAL HEAD OF INVESTOR RELATIONS: On the peers, Lee, it’s a very good question. Clearly we can do benchmarking for our UK ringfenced bank versus our big peer banks, and we do so. It’s the same in what we call GB&M, same in the US, in China, and obviously our home market of Hong Kong versus other large Hong Kong banks, but the short answer is at the group level there’s no one direct peer in trade. We’ve obviously got three or four banks who are also global, but much smaller than us. We’re double the size of number two. For example, in transaction banking it’s basically us and Citi, then you go down to our peers who are a lot smaller than us.

You won’t have seen it yet, but just so you’re aware the peer group for remuneration purposes has changed this year, and there are more Asian peers within it. We have made a few changes to peer groups who basically make it Asian-centric as the centre of gravity for the bank moves more to Asia. That’s in the Report & Accounts if you want to have a look at that.

GREG CASE: Yes, sure. One last piece of Lee’s question. He also asks, ‘As it relates to the securities with LIBOR-based coupons, should we be expecting LIBOR consent solicitations to be announced by 30 June?’

CARLO PELLERANI: Lee, as we have said before, we have no intention of leaving investors with LIBOR risk without before offering them a modern alternative. That is, of course, depending security by security when that impacts you. In the case of the disco specifically there is a closer timeframe for us to look at that, so you should expect something imminent from us in terms of offering remediation for those. The form of that offering is still under discussion. We haven’t concluded what it is, but you should expect something imminent that regard.

GREG CASE: Thanks for your question, Lee. The next question has come from Rob Smalley from UBS. Rob, your line should now be open.
ROB SMALLEY, UBS: Thanks for taking my questions and doing the call. First, on net interest margin developments, you’re projecting continued strong growth in the margin, even with a 50% passthrough of an increase in rates. Could you talk about the development, particularly Hong Kong versus the UK? Some of your peers in the UK are seeing peak net interest margin now. Where are you seeing growth in yours? That’s the first question.

Second is UK-related again. You have a lot of liquidity at the bank. Any other plans to deploy it in any other way? I know that the easy answer is, ‘If we could, we would have already,’ but anything that changed there?

Then finally, on the ECL charge, 600 million for mainland China, 800 for the rest of the book. Could you talk about the methodology there, whether there’s idiosyncratic risks in there, how much of that is model driven, and how you came to that number? Thanks.

CARLO PELLERANI: Thanks, Rob. Thanks for the questions. Let’s start with NII. As you saw, we had NII for Q4 of 9.6 billion. If you annualise that number it gives you about 38 billion of NII. We had a lot of questions earlier today as to what should be our guidance of NII for the full year, and what we have said is we haven’t changed our guidance. What we are saying is that we are flagging more than 36 billion of NII for 2023.

The way we think about it is there are a few tailwinds and there are a few headwinds. On the tailwind side, we have still components of the rates that haven’t repriced yet in our books, so that’s a tailwind. There are some potential additional rate moves that are still in the tailwind, and FX calculations gives us about 500 million upside versus when we flagged that more than 36 billion.

Conversely, there are a few headwinds. The headwinds are potential increases in pass-throughs. Our pass-throughs so far have been inside the 50% long-term averages. We’re expecting from this point on the pass-throughs to start to become closer to the 50%, which implies more than 50% from this point on. An additional headwind is also on the migrations of clients from savings accounts to time deposit. That is particularly relevant in the Hong Kong market, which is extremely competitive, much less so in the UK market. When you put all those things together we end up with the guidance that we thought of at least 36 billion and more than 36 billion for the year.

In terms of the UK market we are starting to see some signs of competition in the UK market, but it is still far from what we see in Hong Kong. At the moment we’re quite confident with the guidance that we have given.

In terms of liquidity, indeed, we are a bank that ends up having a lot of liquidity. What we have done over the last few years is we have become very deliberate about our liquidity management, which clearly is helping us in this up-cycle. Having surplus liquidity in this increasing-rates environment is a competitive advantage, but broadly speaking we created a framework to look at surplus liquidity in each of the entities that looks at what that liquidity should be. Then we look at what the surplus in each of the entities is, and then we lay out a framework that looks at how we deploy that liquidity, how do we invest that liquidity, or how do we reduce it if deploying and investing are not appropriate. Deploying is about business opportunities. Investments are at the margin, if you have the liquidity, what you can do without increasing the risk profile for the bank, and then reduction is about offering different products to our clients and potentially finding intra-company solutions.

So we put all those things together. We are quite active. I would say, given the current rates environment, that the reduce dimension has become less of a priority than it was when we started this a couple of years ago. Richard, do you want to cover China?

RICHARD O’CONNOR: The ECL charges as you’ll expect is a on a bottom-up basis but you’re right, to some extent the $600 million on China CRE is based on a bottom-up view of our particular borrowers and their particular situation and circumstances, and then clearly we
then look at it at an overall provision coverage level. Is that sensible? What is the downside scenario? What are peers doing? And so on and so forth.

So, as we said this morning, we’re comfortable with that charge as of 31 December and we also said that the situation in that sector has improved since the year-end. It’s still very early days. I think there’s still a lot to work through, but I think you’ve seen a positive policy development in the last couple of months, whereas in Q4 you did see some deterioration. So we’re still very watchful on that sector, but more positive.

The rest of the book, not much to say, really. 30 bps, broadly spread. UK, a pretty normal charge. Mexico, a pretty normal charge. Those are our big books. Again, broadly split between retail and wholesale. No big tall trees in there or no big overlays or what are called FEG adjustments, or ‘forward economic guidance’ adjustments. So a pretty standard quarter for the book outside the China CRE 600 million charge, which we called out separately.

ROB SMALLEY: So can we assume that the go-forward of ECL, from a model-driven basis without anything idiosyncratic, should be in around 30 basis points over the next several quarters?

RICHARD O’CONNOR: We guided at 40 and, as you know, our guidance range is 30-40, so we’re at the top end of that range. That reflects difficult economic circumstances at the moment with high inflation and so on and so forth, some companies going through cashflow difficulties staying in the retail sector. So that’s the reason why we’ve struck it at the top end of the range. Obviously China CRE, as we’ve mentioned already, we’ve been making provisions there over the last 18 months or so. 30-40 is our guidance range and for now we’re sticking at the top of that range, given our caution early in the year and given the difficult economic circumstances which much of the world has found itself in the last few months.

GREG CASE: We’ve got some more questions submitted over chat. So from Rob Thomas at T. Rowe Price, Rob asks, ‘Outside of China CRE, are there any areas of particular concern that you’re monitoring closely?’ and also, ‘Can you update on the progress of the sale of the Canadian business? How is this transaction to occur and what’s the timing?’

RICHARD O’CONNOR: On the first, as you would expect, our two big books are our books in Hong Kong and the UK. Clearly in Hong Kong it’s the Hong Kong books’ China CRE which has been the issue. The book outside of that has been very, very, very solid and remains so during 2022 and so clearly, whilst we’re obviously watchful of the market – it’s a big market for us. It has had economic difficulties in the last year. Touch wood, it seems to be coming out of those difficulties with reopening pretty strongly. Albeit it’s still early days there, but certainly all the signs are positive in terms of Hong Kong recovering during 2023 and beyond.

And then our other big book is UK and, again, it’s really we’re watchful on the small businesses and small and mid-size companies in the commercial sector, some of whom have cashflow difficulties. As you’re aware, a fair chunk of the small business market is government guaranteed but, even there, we’re obviously watchful. So those are the areas we’re really watchful. Elsewhere in the world I suppose it’s the idiosyncratic credit risk. In a particular company, in a particular sector, you can get one or two of those each quarter, but I would say those are the major points which we’re watching at the moment.

In terms of Canada, nothing to add to… when we’ve just announced it a month or two ago. We’re working through the regulated processes, as you’d expect, and that’s on track with nothing more to say. I would expect us to give you a more fulsome update on where we are in the process probably at the half-year. We continue to think that it will take much of 2023 to work through all of the various regulatory and other processes we’ve got to work through.

GREG CASE: Thanks for the questions, Rob. Another question submitted via text has come from Paul Fenner-Leitao from SocGen. I think, Paul, we’ve covered your first question, but
on the other two, ‘Specifically on stage 2, a big jump in total balances but no change in provisions. Why is that?’ and also, ‘What can we expect for the remainder of the year?’ Paul notices the jump is in retail, but you would have thought that corporates would have been the most volatile in the stage 2 balances.

RICHARD O’CONNOR: Yeah. It’s a methodological change on UK mortgages. Nothing to flag. It’s just a methodology change. UK mortgages do perform well for us. It’s a very solid asset class, so really – and it’s explained in our Report & Accounts in more detail. It’s more of a technical change than anything else. I wouldn’t flag anything there particularly of concern. The book continues to perform very well for us.

And nothing much to say, again, in stage 2 in wholesale. Obviously you’ve seen some of the China CRE book go from stage 2 to stage 3 during particularly Q4, but also some in Q3 as well, but nothing else to call out there in terms of anything more than normal quarterly volatility in the wholesale stage 2 area.

GREG CASE: Thanks for those questions, Paul. Just a reminder, if you do want to ask a question over the phone, please do raise your hand. Otherwise, we have some more questions submitted over text from Ellie Dann at Morgan Stanley. Ellie, I think we’ve answered a couple of the questions that you’ve submitted, but there’s a couple here that we should cover.

Ellie says, ‘I noticed that your AT1 issuance plan is $2 billion and is less than total redemptions for all the AT1 calls you have this year. Given you’ve been operating above the efficient AT1 level, are regulators happy for you to reduce your AT1 bucket in calling of those and not replacing?’

CARLO PELLERANI: Hi, Ellie. Thanks for the question. Yes, the answer is ‘yes’. There isn’t an AT1 bucket specifically in terms of regulatory requirements; there is a tier 1 bucket, so we look at the tier 1 in totality. The amount of tier 1 that we’re issuing this year in comparison to the calls is indeed part of the plan to normalise the total amount of the AT1 stack to the levels that I flagged we think we are comfortable with. So, yes, we are comfortable with that and also the discussion with the regulators is consistent with that.

GREG CASE: And then I think it looks like last one, from Ellie as well. ‘Does the sale of the Canadian operations free up some cash for the redemption of legacy securities trading above par?’

CARLO PELLERANI: That’s a creative connection between one area and another, which we don’t quite connect at all. The way we think about the Canadian proceeds is priority one is to pay an extraordinary dividend that we are foreseeing to be 21 cents. After that, it’s going to be a combination of additional buybacks and investment for growth. We haven’t quite decided what the proportion of the last two are. That’s the way we’re thinking about it.

GREG CASE: Perfect. Okay. That wraps up the call, so thank you very much everyone for dialling in and for your questions. Please do let us know via the usual channels if you have any further follow up questions. Thank you.