Edited Transcript

Post-3Q 2015 Earnings Release

Meeting with Analysts hosted by Iain Mackay, Group Finance Director

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Corporate participants:
Iain Mackay, Group Finance Director
Russell Picot, Group Chief Accounting Officer
Jane Leach, Group Capital Controller
Rob Irvin, Head of Business Reporting

HSBC

Iain Mackay, Group Finance Director

Good morning, everybody. Welcome to the third-quarter analyst meeting. I'm sure you've had a more-than-ample opportunity now to go through the numbers, so I think we should go straight into Q&A.

Alastair Ryan, Bank of America

Costs, please. I'm sure we'll go on to things you can't control as the meeting goes on, but we'll start with things you can. What's the actual cost expectation? And just work back through us, please, with other costs which you're now expecting to be broadly below the line this year and next: so, mark-to-market for currency, mark-to-market for disposals, actual costs the bank will incur, and those costs that you'll consider to be recurrent or adjusted.

Iain Mackay

So, I think probably page six of the slides that we used for the third quarter probably lay out most of that. On the left-hand side of that page, we've got the 2014 adjusted for Brazil and Turkey and foreign exchange. And just to clear one point up on that: I noticed a number of comments from some of you that had said that we'd accounted for Brazil and Turkey on a held-for-sale basis. We account for Brazil on a held-for-sale basis, not Turkey on a held-for-sale basis, because we knew, when we put Brazil in that status, that Turkey was proving to be a harder transaction and was not imminent. And as a rule, when we have a transaction that is imminent, then we move the assets and liabilities into held-for-sale, at least under International Financial Reporting Standards; not Turkey.

That gives us 2014 pro forma. Some FX impact in there. Normalise that for the bank levy, and then you've got an exit rate, pro forma 2014, of $30.2 billion, excluding the levy. So, if you then translate that into a quarterly run-rate, ex levy, you come out at the $7.6 billion per quarter. And that, if you like, is the recurring cost base for the firm. So, that would not include significant items, which, for example, includes the development costs for the ring-fenced bank in the UK as well as costs to achieve. So, when we do reductions in force, as we demise applications in the software space, as we close branches, those costs would appear within costs to achieve.

So, what the $7.6 billion run rate reflects is the ongoing operating expense of the bank. That includes run-the-bank, both front office and back office, as well as change-the-bank, front office and back office. It does not include the cost to achieve. The cost to achieve, we would expect to peak somewhere around late 2016-2017, and we'll provide more detail on what those costs to achieve are as we progress through the process of realising the cost saves, which, based on Investor Update and the outlook from a revenue perspective, were informed at $4.5-5 billion. And as we said on the call last week, if the economic environment should be such that the revenue outlook changes in an adverse manner, then our cost actions will be informed by the ability of the firm to generate revenue.

At the moment, we're still reasonably optimistic about achieving overall revenue levels that we talked about in terms of the Investor Update back in June. We've obviously had a fairly interesting third quarter in a couple of geographies in which we operate. Also, I think it would be accurate, certainly from our evaluation, that the impact that we saw in the third quarter was cyclical as opposed to structural in nature very much as it relates to Retail Banking and Wealth Management. It correlated to corrections within the Asian stock markets, impacting some of the wrapped products that we sell through our life insurance business.

And to a lesser degree, we obviously had the ongoing impact, which I think we'll get a better annualised view of as we enter the first half of next year, in terms of reduced overdraft fees in the UK, which is a significant reduction in Retail Banking and Wealth Management revenues, as we warn customers that they either have already gone overdrawn or that they're about to go overdrawn and, therefore, hopefully, results in a correction there, an adjustment in their behaviour, which, hopefully, is good for the customer but, clearly, has an adverse impact on our revenues in that regard.

So, Alastair, page six is the page that we'll continue to provide as we go forward. So, we'll correct the cost base for foreign exchange, and then any other impact that needs to be impacted to normalise it back to the 2014 run rate to come up with an exit rate for 2017, we'll continue to reflect that on a quarterly basis as we go forward.

Manus Costello, Autonomous Research

Could you do the same for revenues? Just the underlying quarterly run-rate ex the exit businesses.

Iain Mackay

No, I don't think we will. . Brazil is going to be out of the equation early next year, hopefully – first half of next year – and Turkey, we'll see. We'll certainly provide you with the impact of any disposals from a revenue perspective.

Rohith Chandra-Rajan, Barclays

You discussed in quite a lot of detail on the call the drivers of the RBWM revenue progression. Just looking at that in a bit more detail, trying to strip out some of the one-offs and accounting funnies in the quarter, it looks like non-interest income was down over $600 million Q-on-Q, so I just wanted to check that was consistent with your understanding and your view of the numbers. And you talked about the $200 million – $214 million; I think you said – from the mark-to-market on the life insurance business.

Iain Mackay

That's right.

Rohith Chandra-Rajan

I'm just wondering what the balance of $400 million would be, if that's the right number. I'm talking about Principal RBWM.

Iain Mackay

So, only Principal Retail Banking and Wealth Management. I think you're talking about non-interest income, aren't you? So, from a net-fee-income perspective, we were down about $130 million, and then other income, $180 million. So, overall, revenue was down $283 million in principal Retail Banking and Wealth Management. Net-interest income was up $61 million. Net-fee income: the main driver of the reduction in that was the overdrafts to which I referred. That was the lion's share of the $130 million reduction in net-fee income. In trading income, I think that's simply the effect of mark-to-market in terms of some of the hedges within the Retail Banking and Wealth Management business. And then, in terms of other income, we had a reduction of $180 million and, in terms of other income, it was mark-to-market as well. So, I'm not quite sure where you're picking up $600 million in terms of reduction. Are you doing quarter over quarter or second quarter to third quarter?

Rohith Chandra-Rajan

Yes, so Q2 to Q3.

Iain Mackay

Okay, so I've just explained 3Q15 versus 3Q14. Moving to 3Q15 versus 2Q15, revenue was down in Principal RBWM by $571million. This was mainly in Hong Kong, where revenue was down by $364 million, and in France, where revenue was down by $209 million. In Hong Kong, we saw a very strong second quarter in Investment Distribution from brokerage revenues on the back of Shanghai-Hong Kong Stock Connect. Revenue then fell by around $200 million in the third quarter reflecting lower volumes due to weaker investor sentiment. There was also the impact in Hong Kong of adverse fair value movements on Life Insurance Manufacturing in the third quarter due to the stock market correction, resulting in a fall in revenue of around $190 million. In France, we had a reduction in revenue following favourable movements in present value of in force insurance business in the second quarter.

Rohith Chandra-Rajan

If I could just ask about Brazil as well, you mentioned the first half of next year as the completion. Are there any break clauses in the contract?

Iain Mackay

No. Other than the usual contractual force majeure, no. They don't get to bail out for any reason other than a force majeure.

Rohith Chandra-Rajan

And that's progressing to plan, I think you said.

Iain Mackay

It is. It's progressing well.

Chirantan Barua, Sanford Bernstein

I was just going back to all the 10 points that you have on the cover sheet. So, Pearl River Delta: a lot that you've spoken about. Can give us a sense for: what is the size of the book right now? Is it a retail book, commercial book? What is the composite position? In the short term – long-term, I understand the capital deployment – who are you lending to right now and what kind of rate of growth?

Iain Mackay

In the Pearl River Delta at the moment, this is largely a corporate book of business. Our outlets in the Pearl River Delta, which is a large geographic area, but let's describe it broadly as stretching from Guangzhou in the north down to Qianhai in the south, near Hong Kong, we've got about 60 outlets, which are branches and sub-branches within that geography. Those branches largely serve Commercial Banking customers, and the bulk of revenues generated presently from the Pearl River Delta is corporate business. So, our Retail Banking and Wealth Management business is the smallest of our businesses in mainland China presently.

The strength of that business is largely within the Shanghai-Beijing corridor. The Retail Banking and Wealth Management business has traction and is beginning to grow in terms of the Pearl River Delta. It is that business, as well as the corporate businesses, on which the focus of redeployment of capital over the course of the next three to five years, because the Pearl River Delta has a much longer burn than the timeline that we gave around the redeployment of $150 billion plus of the $290 billion saves in risk-weighted assets. But at the moment, the preponderance of business within the Pearl River Delta is written out of corporate.

Chirantan Barua

How big is the book, Iain, right now?

Iain Mackay

I don't have the detail off the top of my head in terms of Pearl River Delta specifically.

Chirantan Barua

Is there any other foreign bank which competes with you? Who is your competition there?

Iain Mackay

So, I'll give you an example of the Qianhai development, a free-trade zone as part of the Shenzhen area, which is closest to Hong Kong. That, today, has only one foreign bank operating in it, and that's HSBC. In terms of other foreign banks operating in the wider area of the Pearl River Delta, you'll see the odd Citibank branch, you'll see the odd Bank of East Asia branch, you'll see a Hang Seng branch, but that's 60% ours as well. Interestingly, what you don't see presently are Singaporean banks or the Aussie banks present in that area. Their area of focus of development tends to be more ASEAN-oriented as opposed to north-east Asia – at least that's the case for the moment.

Raul Sinha, JP Morgan

Can I ask a question on slide nine and just on core Tier 1? In the last meeting that we had about a quarter ago, you talked about how it will be quite difficult for the firm to get to 12 excluding the impact of Brazil by the end of the year. And obviously, you've done 20 basis points this quarter, so I was just wondering if there are any items that you would like to flag for the fourth quarter that we should keep in mind.

Iain Mackay

You mean the ones I usually flag, like the bank levy?

Raul Sinha

Yes, and the dividend.

Iain Mackay

That's $1.6 billion that comes out – about $1.5-1.6 billion – for the bank levy in the fourth quarter, which, clearly, has a fairly significant adverse effect on capital generation. And then, in the fourth quarter, we will account for the fourth interim dividend. And between the two of them, they pretty much wipe out capital creation in the fourth quarter.

Raul Sinha

But obviously, this is slightly different in the sense that you're building momentum in your RWA initiatives, so you had about 30 basis points benefit this quarter from that. Would you expect that to accelerate from the third into the fourth?

Iain Mackay

Well, Jane, feel free to chip in here but, over the last couple of years, what you've seen in the fourth quarter is a drop of 10 to 15 to 20 basis points in the fourth quarter. I think, if anything, the RWA work that we're doing and the extent that we recognise that in the fourth quarter will possibly mitigate some of that impact. So, it would certainly be encouraging from our standpoint if we didn't see too much of a reduction in that Common Equity Tier 1 ratio in the fourth quarter, but clearly, with a bank levy of $1.5-1.6 billion, a dividend which we intend to be progressive, we would expect… without a very significant contribution from RWA reduction, we'd expect to see the ratio in the fourth quarter being slightly weaker.

Jane Leach, Group Capital Controller

Absolutely. Last year at Q3, we were at 11.4% and we then went to 11.1% at Q4. So, I think that answers your question, really.

Iain Mackay

So, I think, absent Brazil – and it would be awfully nice if Brazil did close in the fourth quarter, but I suspect it won't – but absent Brazil, we will not make 12% by the end of this year.

Raul Sinha

And just to follow up lastly on FX, given there's some very sharp moves in the FX markets already, could you remind us of what hedging you currently have on the books?

Iain Mackay

So, the most significant hedging that we do from a capital perspective is in the sterling bloc. We revisit that with Samir's FX team on a pretty regular basis in fact. Bryan Pascoe, our Group Treasurer, and the team are in that process this week, looking with an expectation of what might happen if there was a Fed move on the base rate in December or what that might do in terms of weakness in sterling, which is certainly what's anticipated. We've hedged the vast majority of our sterling exposure, just revisiting the development of the UK book overall and in terms of whether there's any further element of that exposure that we might hedge. But sterling is the bloc in which we do most hedging. When you look at other exposures, trying to do exposure hedging to renminbi is really difficult. There's just not enough liquidity in the market.

Raul Sinha

The euro seems to be having quite a big impact, and historically has had.

Iain Mackay

Yes. We've done a little bit but not a great deal within euro from a hedging standpoint.

Chirantan Barua

Just a quick follow-up on that, you hedge the core Tier 1 ratio or do you hedge the capital position only?

Iain Mackay

No, we're hedging the capital.

Chirantan Barua

Not the core Tier 1?

Iain Mackay

We're looking at our net exposure assets and liabilities and hedging that.

James Invine, Société Générale

On the call, you said the total exposure to China was $140 billion. I think, at the halfway stage, it was closer to $170 billion. I guess we've had FX moves in the third quarter, but it's still quite a chunky decrease just for three months, so can you explain where the changes are coming from and if that's a deliberate decision to scale back China exposure?

Iain Mackay

So, FX was the largest single impact; however, for the last 18 months – and we've talked about this previously – over the last 18 months to two years, within mainland China, with a particular focus on financial institutions, as a firm we've adopted a similar approach to that which we adopted with eurozone exposures back in 2009 and 2010 – and 2011, for that matter – in terms of trimming back exposures to counterparties over which we either had less transparency than we would like, concerns over the exposures and the type of business that some of those counterparties in terms of the extent of exposure to local government funding vehicles, commodities, certain types of trading activities. And over the course of the last two and a half years, we've reduced gross exposures to the Chinese financial institution sector by more than US$30 billion. Part of that work was realised in 2014, but also a significant component of that was realised through the first three quarters of 2015 as well, and it's an ongoing piece of work in terms of ensuring that we've got as clear an understanding as possible of the exposures. There's clearly a lot of leverage sitting within the Chinese system, and we'd prefer not to get caught out by an institution not having appropriate controls in place.

James Invine

Putting that to one side, the customer loan book: did that continue to grow in the third quarter or is that down as well?

Iain Mackay

Broadly speaking, the book, from a volumes perspective and net of foreign exchange, was pretty much flat, quarter-over-quarter, within China. Within Asia broadly, exposures came down about $4 billion, and that was exclusively in Global Banking and Markets, related to a small number of Global Banking clients for which we had large short-term financing transactions in place, which ran off in the third quarter, and that was about a $4 billion impact, I think.

Andrew Coombs, Citi

Perhaps I could first ask you just to comment on your thoughts on the TLAC paper that came out yesterday; obviously, much the same as we'd seen before but a couple of amendments, so your thoughts both on external and internal TLAC requirements, and potential costs there as you roll over onto TLAC-eligible debt.

And then the second one would just be: in terms of the UK ring-fenced bank, implementation in progress, to be completed by 2018. Can you just remind us what you said on the cost of that for you, and whether that's booked in your underlying operating expenses or whether that comes through in the costs to achieve?

Iain Mackay

So, from a booking perspective, the set-up costs for the UK ring-fenced bank is a significant item, so these costs are excluded from adjusted operating expenses. We designated it as a significant item for the first time in the third quarter of this year and, in the slides, there's 28 million in the third quarter. To be clear, these costs are a separately disclosed significant item and are not part of the costs to achieve number that we report. However, on a year-to-date basis, the overall spend on ringfencing is just short of $100 million, and don't expect it to be much more than that for the full year in terms of ringfencing activities. The overall estimate for ringfencing remains consistent, of between $1-2 billion. The breadth of that range is largely informed by the fact that the technology, the systems separation that is required between the non-ringfenced bank and ringfenced bank is a very significant undertaking. And secondly, sort-codes reattribution.

Sort codes are, obviously, unique identifiers for payment processes and, where we need to move certain customers that sit within a sort code that will be designated as ringfenced that needs to go to non-ringfenced, or vice versa, that, from a retail-customer perspective, is a fairly straightforward process and, mostly, the number of retail customers that will be impacted is not insignificant. It's in the range of probably about 100,000-150,000 customers, which is not small but not huge either.

However, for a corporate customer, that's an extremely complex process. At the moment, we're running pilots with customers across the corporate space and, as we complete those pilots – we're running 40 of them, I think it is – as we complete them, it'll give us a better sense as to the actual cost of migrating those customers, and then we'll tighten up the range of the expected total cost to implement as we get better insight around that. And in the first quarter, we'll have a much tighter fix on what it will take, from a technology perspective, to separate the two organisations. So, I would expect, in the first half of next year, we'll start to narrow the range from the $1-2 billion; hopefully, less than 2. That's certainly the marching orders that we've given the teams.

From a TLAC perspective, fair to say that what came out yesterday was not drastically different to what we saw a year ago, or in August, for that matter, but I think there are still quite a lot of questions that need to be answered. So, for example, it does not address how associates are to be TLAC'ed or not TLAC'ed, and we have a couple of fairly significant associates within the Group that consume a not insignificant amount of risk-weighted assets. So, there are still areas which require clarification from regulators.

I think, in December, we will get interpretation from the PRA in terms of how they intend to implement MREL and TLAC. That's important because there's quite a lot of national discretion permitted by the paper that came out yesterday, and the paper that came out from the Fed last week clearly illustrated that discretion, because the approach that they're taking is very different to that which, broadly speaking, is proposed in the paper published yesterday.

The US seems to suggest that they expect, for foreign-bank organisations, that all the TLAC would be internal TLAC issued to ultimate parent of the group, whereas, certainly, I think our expectation had been that we would have an intermediate holding company, which we already have. The Foreign Banking Organization (FBO) changes within Dodd-Frank did not impact HSBC to any significant degree, because we already had not one but, in actual fact, two intermediate holding companies in the US, one of which already issues instruments to the marketplace.

One of the areas that we need to follow through with the Fed – and it was a consultation paper, so we will consult on it in some detail – but one of the areas that we'll consult with them is our preference, when looking at the resolvability, because this whole thing, as the paper talked about at great length, is about resolvability. But from a resolution standpoint, we've worked very diligently with the PRA, the Bank of England, the crisis-management group on a multiple-point-of-entry resolution construct for the Group. The proposed approach from the Federal Reserve would possibly put a bit of a kink in that plan, if all the TLAC had to be issued from the ultimate company and downstreamed. In resolution, in effect, the losses would be absorbed up through the chain to the parent company, and that would be slightly inconsistent with the multiple-point-of-entry resolution construct.

But national discretion is important. Hopefully next month, the PRA will give indications to the market about MREL and TLAC as implemented in the UK. Hopefully we will get some clarification on how associates would be treated, for example, and the exact composition of resolution entities and sub-groups within the overall resolution group within the GSIB are areas that we need to consider.

The range is slightly better than we expected. In our usual pessimistic fashion, we thought that the range would be at the upper end, but sitting at 16-18%, with the timelines to implement it, that's good news. In terms of overall volumes, we laid out an example of the three major resolution entities, as we've identified them, in the Group as part of the investor update and put in a range of $45-50 billion of TLAC issuance. If you expand that out to the Group as a whole, beyond those three major resolution entities, with the paper that came out yesterday, a very high-level estimate, recognising there's quite a lot of stuff that we need to sort out, as I mentioned, we're probably talking about an overall Group range which is north of $60-70 billion.

Russell Picot

The FSB also published a consultation paper on the capital treatment of holdings of TLAC. We are looking at how that might interrelate with the US proposals because that might suggest that those internal holdings, if they go all the way up the chain, might result in a Tier 2 capital deduction. The interplay of all of this is something that is being looked at the moment.

Chintan Joshi

On the investor if I remember correctly, a high of a billion for TLAC costs from the three entities, so should we just scale up that billion in the ratio have given us?

Iain Mackay

We gave a range of 200-400 million for those three entities. You need to scale up the 200-400. There's an awful lot of detail to work through on this, but I think the costs… If we had to issue, for example, up to $60-70 billion, then going from $45-50 billion that we talked about to the $60-70 billion, you scale it up and you double the numbers.

Martin Leitgeb, Goldman Sachs

One follow-up on the ringfence and one on asset quality: Are there any plans at this point in time to shift some of the assets out of the UK in order to optimise for the future ringfenced structure?

On asset quality: we saw quite dispersion on risk costs across EM-exposed banks, with, HSBC being by far the lowest at this point in time. Could you comment on the outlook for risk costs, in particular in Asia, and where you see pressure points arising, and what implication there might be for risk costs as a consequence of the rate hikes in the US and the potential flight of liquidity out of emerging markets.

Iain Mackay

Ringfence: in terms of moving assets out as it relates to the ringfenced bank, no. We've discussed with the PRA that the Retail Banking and Wealth Management and the Commercial Banking – or certainly the vast majority of the Commercial Banking business – would be inside the ringfenced bank. Private Banking, we anticipate, would be a separate subsidiary within the ringfenced bank, and those businesses would remain largely whole as we go through the creation of the ringfenced bank.

When you talk about the non-ringfenced bank, it's basically Global Banking and Markets that would sit within that non-ringfenced bank. And within the risk-weighted assets initiatives, a great deal – almost 50% of the risk-weighted asset reduction that we're talking about – is from the Global Banking and Markets business and, within the Global Banking and Markets business, the vast majority is coming out of Europe. And out of Europe, the vast majority is coming out of the UK, which is the non-ringfenced bank.

In terms of design work around the non-ringfenced bank, there is work that needs to be done in terms of how it's funded and, again, that will be largely dependent on more insights from the PRA as to what, if anything, can be done in terms of funding between the non-ringfenced bank and the ringfenced bank. If there is to be none, then there is clearly work to be done from a funding perspective on the non-ringfenced bank, and the extent to which that funding and capitalisation of the ringfenced bank is informed by greater insights from the PRA, it will inform whether we either ship business out of or into that non-ringfenced bank, but that's work that will proceed over the course of the next couple of years.

On asset quality, Asia is showing remarkable resilience. That goes for mainland Chinese credit quality, Hong Kong credit quality, and the broader region. The areas within the region that are getting slightly higher levels of monitoring than would normally be the case are markets which are particularly exposed to commodities and oil and gas and, within that, Indonesia and Malaysia. Neither are particularly big businesses for us. At the moment, the credit quality is quite stable. We're seeing a little bit of negative migration but it's at the margin only.

Other regions within the Group which are getting very close attention, not so much in terms of the here and now but what might happen over the course of the next 12, 24 or 36 months, is Middle East and North Africa. A number of economies there are clearly, to a significant degree, dependent on the price of a barrel of oil, and one of the areas that we've done stress testing over the course of the last year or so and are undertaking further stress tests as we speak is on the prolonged lower oil prices and what impact that may have on those economies, and government finances within those economies over the course of the next two to three years.

And we did see slightly higher credit costs in the Middle East and North Africa in the third quarter. That was informed by higher collective provisions on our mortgage portfolio within the United Arab Emirates – specifically, Dubai – where – and this is an industry issue – where perfecting collateral from a documentation standpoint is proving quite difficult. So, we've increased provisions to reflect, in effect, provisioning levels against non-secured business within that portfolio, whilst, at the same time, obviously, doing the work necessary through the courts to try and improve the quality of collateral that we've got in that portfolio. And then we had two Commercial Banking customers for which we booked individual loan-impairment allowances, interestingly, not directly or even from a secondary perspective, related to the oil industry, but it is a market which we're focusing on much more closely.

Mexico: fairly stable; improving credit costs. The US remains very stable. And when you talk about rate sensitivity in the US, 25 basis points on the Fed rate in the US, we believe, will have absolutely no impact – in fact, up to about a point and a half, we believe, will have absolutely no impact on overall credit quality within our Retail Banking and Wealth Management and within our run-off CML portfolios. Many of the mortgages within the run-off CML portfolio were modified back in 2007, 2008, 2009, 2010 ad 2011, and modified from adjustable - or variable-rate mortgages - to fixed-rate mortgages. And as a consequence, those which sit within the $20 billion of unpaid principal balance now are very much less sensitive to rate movements than they were back in 2006-2007.

And more widely, in terms of rate movements and the overall quality of our mortgage portfolio, the mortgage portfolios, on a global basis, are underwritten, from an affordability perspective, at much higher interest rates than those currently prevailing in the mortgage markets, whether here, Hong Kong, France, US, anywhere. They're stressed, from an affordability perspective, by 350-400 basis points.

Manus Costello

On asset quality in Asia: Am I right in thinking that you're no longer providing disclosure – not so much in Q3 but at the interim stage, you didn't give the regional asset-quality data that we used to get, and I wondered if we'll get that in the future? Because there's obviously an increasing focus on it and you used to give the regional and the loan categories, and it was notably missing. But I then went to the

Hongkong and Shanghai Banking Corporation data, and that shows that non-performing loans are going up, and they are going up in corporate in particular, and I wondered if you can reconcile the very soothing words you've given us about the outlook for NPLs with the fact that the trend – we don't know about Q3, obviously – but the trend up to the first half has been of rising NPLs in The Hongkong and Shanghai Banking Corporation.

Iain Mackay

Yes, it's risen by nine basis points over this year.

Manus Costello

Is that in the first half or up to Q3?

Iain Mackay

Yes, it's Q3. And a nine-basis-point deterioration – and that's non-performing loans; that's not loan-impairment charges. And that, from the credit team's perspective in Asia, and from a Group risk-management perspective, is certainly something that merits attention but it's not something that merits particularly panic stations. And as you can see, it's not, at this point, translating into significantly higher loan-impairment charges although, the overall rate, you did see climb about four basis points over the course of this year, I think from 15 basis points to about 19 basis points overall for Asia.

It would be very odd if we didn't see this, in this environment, with lower growth coming through not only the Chinese economy but the Hong Kong economy and other economies. However, we're still seeing attractive opportunities from a credit and lending perspective, and taking market share in areas like payments and cash management, and global trade and receivables financing compared to virtually everywhere else in the world. It would very odd, in this kind of environment, if we didn't see some form of credit migration to a higher proportion of non-performing loans, but that proportionality, at this point, is still very muted.

So, I'm not trying to convey to you that life is a complete bed of roses and nothing will ever go wrong, but there isn't enough indication out there at the moment that tells us that we've got a major storm brewing out on the horizon for us. We don't see it. It doesn't mean that, as the months unfold ahead of us, we might see further deterioration, but I've spent the last week in China and in Hong Kong talking to customers and talking to colleagues at the bank in Hong Kong and in China. The sectors into which we're lending continue to perform reasonably attractively.

And we've experienced this over the course of the last three years and we've seen it clearly in our volumes and we've seen it clearly in our margins: the level of export activity, which drives – import/export – which drives trade volumes, we've seen that drop off significantly over the last three years. We've seen margins adversely impacted for the last three years, but we've seen those volumes and margins stabilise in 2015. So, for the first nine months of the year, global trade and receivables financing revenues are almost flat to those of 2014, and margin is one basis-point off compared to the same period last year in that product line. But that's after two and half years of very significant drop-offs.

The reason we've been able to maintain revenues is that we've taken market share in a lot of those geographies. And it's simply, in this rate environment, it's not a particularly profitable product range. It is driven by technology, process and the network. And from a product-offering perspective, we've got one of the best in the marketplace and, from the network standpoint; we have the best in the marketplace. In terms of customers looking to one counterparty to try and serve them across that network, it's been one of the main drivers for us picking up market share in trade and receivables financing. But compare it to a year ago, it's slower; compare it to four years ago, it's a lot slower.

Robert Sage

A couple of quick points: first of all, just in terms of the effect of Asian slowdown, if any, in terms of wage inflation within the region, there's been a lot of talk over the years about this being naturally rising, I don't know, 3%, 4%, 5% per annum. Are you seeing that at all moderating under the current circumstances?

The second question was: just in terms of Mexico, you alluded to asset-quality trends being fairly stable. Just looking in terms of the performance of the first nine months, you've seen a tremendous improvement in terms of the profitability to I think you're saying $0.2 billion, but your target is $0.6 billion, and I was just wondering whether you're comfortably on target for actually meeting the $0.6 billion, because it still seems to be quite a long way to go.

Iain Mackay

In Mexico, it is still quite a long way to go. There's still a lot of work. We've clearly seen profitability improve dramatically in Mexico. That's, to a significant degree, been informed by much lower loan-impairment charges coming through the book and, last year, loan-impairment charges were, to a significant degree, informed by the homebuilder sector, where there was a change in government regulation in terms of how and where certain property developers could build low-cost housing. So, last year, loan-impairment charges were, to a significant degree, informed by that homebuilder sector. Loan-impairment charges this year are much lower, principally because that was dealt with last year.

Revenue growth within the Mexican market has been fairly muted. That continues to be informed by the fact that we are very much focused on implementing global standards, but I think the business is finding a better balance between the implementation of those global standards and de-risking the customer portfolios with rebalancing more towards growth, particularly when looking at corporate customers.

But clearly, one of the things that we need to get working to rebuild the profitability of the Mexican business is the Retail Banking and Wealth Management business in that market. We have just under 100 branches in that marketplace. It is very well located but, for the Mexican business to be successful, we need the Retail Banking and Wealth Management business to be successful. But to be clear, within the Retail Banking and Wealth Management business, we exited more than a million customers over the course of the last two years from a global standards perspective, so there's a rebuilding piece of work to be done in Mexico. There's still a lot to be done but the team's making good progress and we're reasonably encouraged by that, but there's a lot that remains to be done.

Cost inflation: one of the things that will perversely benefit us from the disposal of Brazil is that was a key driver of wage inflation. There were union-agreed, across-the-piece inflationary impacts every single year, which, in a large business, had a significant impact on inflation. Other key drivers are within the Asian markets, and we do not expect to see inflation moderating to any significant degree from a wage-bill perspective. We still look at 4-5% per annum, and that is, in actual fact, what the market commands in terms of changes on a year-over-year basis.

Alastair Ryan

On the credit quality in Asia, historically, if you go back to your book in the past, would you have seen deterioration by this point in the cycle, if you were going to? You haven't seen material deterioration but, in a previous commodity shock, would you not have seen it? It's obviously useful information. You haven't seen deterioration, because other people have, but there's a lag between prices falling and companies not being able to pay.

Iain Mackay

In the last30 years or so, the two significant events impacting credit quality in Asia were the Asian financial crisis in '1987-'88, and SARS epidemic in 2001. I was, actually, the CFO in Asia Pacific in 2009 and 2010, when the rest of the world was engulfed in the financial crisis, and credit quality remained very stable through that period in Asia Pacific. There were, clearly, companies that experienced some stress but, in the round, credit quality within Asia Pacific remained very stable.

A couple of exceptions to that: India and Indonesia, if I remember correctly, both of which were characterised by consumer-lending portfolios. We deployed consumer-lending business into markets with no credit-scoring bureaux and those portfolios had to be restructured, closed, and those portfolios did experience higher credit costs in 2009 and 2010, but those portfolios are no longer part of our businesses in those markets.

Alastair Ryan

Andrew Bailey gave a speech 10 days ago, which sounded like it was aiming at telling us that they're done with new regulations, and that they're now moving on. To what extent does that map with your experience of what the Bank of England is doing at present?

Russell Picot

I think it's encouraging that he's prepared to say that, Alastair. There clearly is a series of initiatives that need to be worked through. We've referenced a couple of them this morning. There are one or two quite profound questions still out there. Clearly, the Basel Committee has got an agenda, which it's working very hard to try and land fundamental review of the trading book (FRTB), presumably, landing early next year, the questions about standardised RWA floors and, inevitably, what follows from Basel consultation is European process and Bank of England process.

We're expecting the Bank of England to consult on double leverage in the first half of next year. I think that's a very important topic in a world where you've got intense local regulation, capital levels established for our subsidiaries, TLAC in an MPE world, where you'd look to have separate resolution of those subsidiaries. It does rather open up the whole question about: what's the role of the parent? What's the role of consolidated capital ratios within that new world? And clearly, the pinch point is double leverage.

We were perhaps mildly encouraged to hear Andrew's comments. It wouldn't translate into feeling that there's not really some significant initiative yet to land, both internationally and in Europe and the UK.

Alastair Ryan

Timing-wise, if you think the FRTB is early next year, the other stuff's considerably further out than it was going to be. It all feels like it's drifted off somewhat. Basel, they're still trying to push it up the agendas.

Russell Picot

FRTB, from what I'm hearing, looks like it's on track to land early next year. The finalisation of the rules: obviously, implementation date would be subsequent to that – it's 2018 or 2019, perhaps. I think you're right: I think the sense is that those other aspects of RWA rules may be going more slowly than original expectations. We've had one quantitative impact study (QIS) on standardised approach and, if you think about the number of QISs we did on the trading-book consultations, I think we've probably lost count. It was four or five or something. So, I think your understanding is probably pretty well aligned with ours. I think this is an important piece of work. I think they need to work through quite a lot of detailed aspects of that and, of course, it's a really fundamental question for the industry. You've got to invest all this money in developing your in-house models, and there was a good reason for that and, obviously, incentive to improve risk management, etc. There's a whole series of consequential aspects of that. So, I think there's quite a lot of consultation, discussion and engagement yet to come on the non-trading-book stuff, is my expectation.

Jane Leach

On operational risk and also on the standardised approach to credit risk, both of which are pretty big outstanding areas, they both still seem to be going through some quite fundamental re-thinking. We are not really expecting those to be completely final for a while. Those are areas that are difficult to anticipate.

Iain Mackay

This area runs the risk of getting potentially a little bit messy politically as well. You've got some fairly senior people in the European Central Bank saying, 'Look, we're trying to do everything we can to generate growth within the European economy and you guys down in Switzerland keep cracking out new regulation. It's not very helpful.' It was interesting the comment in the *FT* this morning which apparently quoted — the Governor of the Bank of England, apparently, yesterday, saying, 'First of all, there is no Basel IV. It's clearing up bits and pieces around the edge of Basel III. As they went through the implementation of Basel III they identified some inconsistencies and implementation issues, and that's really where the focus of energy and work is being conducted by the Basel Committee.' To Russell's point, the longer this goes on, the less clear it becomes. The timetable seems to be elongating.

Manus, I'm not sure I entirely answered your question around on disclosure: One of the things – certainly on the back of feedback from this community and, to a significantly lesser extent, the investor community – we're doing is a slightly more informed disclosure around things like commercial real estate or current loan-to-value (LTV) by key exposure markets. That is something we're going to sit down and take a look at what we do in terms of the annual report and accounts. As and when is appropriate – not on an ongoing basis – i.e. when topics become of current interest for the investor community, we'll look at what we can provide in terms of more informed disclosure that helps people understand the differentiated nature of our book or, if it's not differentiated, equally clear exposure about why it's likely to suffer the same vagaries as other market participants.
In all candour, one of the things that we've done – and will continue to do, in fact – and we take a very vigorous look at is that we are deeply conscious of the fact that the annual report, at 500-plus pages long, is really difficult to absorb and very few people seem to read it. It is extremely informative for somebody who really likes this kind of stuff. But how do we make it clear not only about what is happening in the accounts but – what the firm does? How does it do it? How are people engaged in running the business and managing the business, and what does that really mean in terms of economic impact?

Part of that work will be reflected in a little bit of a redevelopment of some of the earlier stages in the annual report this year, and then a much broader look at the whole of the annual report for 2016. Clearly, there are things we have to do because the reporting standards require us to do it or corporate governance in the UK requires it or the SEC requires it. But within those requirements, there are things we do that simplify and clarify some of disclosures that we're providing.

Chintan Joshi

On dividends, amongst the most frequently asked questions is, 'How safe is HSBC's dividend?' If you could help us think about this, if there is a credit cycle and, say, your profits in Asia are down 20%, how would that feed through to the whole dividend decision process, to get an understanding of where the risks are?

Iain Mackay

The dividend process is informed by the profitability of the Group each year. As you saw last year, we did not have a great fourth quarter. In fact, we had a horrible fourth quarter, which informed an overall not great 2014. But it's also informed by strength of distributable reserves and an outlook around the performance of the business in succeeding periods. Overall, however, the dividend will be informed by the profitability of the Group each year. Therefore, what are of the factors which could affect the profitability of the Group? Those factors are those elements which could have the most significant one-time shock effects are things like litigation risks, clearly a great deal of which we have dealt with over the last four years.

But there are still risks out there, whether they relate to foreign exchange securities class-action suits in the United States or Swiss private banking tax-related matters. If one happened, then clearly, as you've seen from the last few years, it doesn't adversely impact our propensity to pay dividends. If all of those came home to roost in the same quarter of the same year, or if in fact they come home to roost at all, then that's one factor that could adversely impact dividends. It's a factor for which we make allowance in our capital plans.

The other obvious things would be, yes, if you saw a significantly adverse credit cycle coming through. Going back to the not-too-distant history, 2007-2009, we saw very significant losses coming through our US consumer finance business that obviously led to the rights issue and the rebasing of the dividend in 2009 and, since 2009, the progressive rebuild of that dividend. It is our goal to continue to progressively develop that divided – in line with the profits of the Group and in line with regulatory capital requirements.

As we talk about what we would like to see settle down versus that which actually manifests, there are great many things we need to take into consideration. That is what we have done for the last few years and that is what we will continue to do.

Chintan Joshi

If you think about the CTAs to come in and some of the litigation risk out there and pressures on profitability because of the revenue environment, the payout ratio on statutory profit has kept on going up. At what point does that become an issue for you? Is it that you have distributable reserves so that is not really an issue?

Iain Mackay

It is going to be informed by cash reserves sitting at Group level. Our model works on receiving dividends from our subsidiaries. To the extent that those subsidiaries can continue to provide robust dividend flow, supported clearly by cash resources at the Group level, distributable reserves and a supportive regulatory environment, then we will. But there is obviously a limit. For one period, I think our payout ratio was 71-72%. To do that now and again is sustainable, but to do it in perpetuity without a much stronger dividend flow from the subsidiaries is not sustainable.

Chintan Joshi

On costs, you mentioned earlier at the start that, if the revenue environment were to remain weak, you would need to do more on cost. When you gave the plan in May and thought about whatever the underlying cost-income ratio was, if the weakness in the revenue environment were to persist, would you still think in terms of that cost-income ratio? You haven't revealed to us, but how is the internal revenue going to adapt to this revenue weakness?

Iain Mackay

It's informed by positive jaws. We're not going to make positive jaws this year largely due to the fact that we had a fairly weak third-quarter revenue. It was very encouraging to see some progress coming through in costs. There's clearly a great deal more that needs to be done from a cost-realisation perspective. It's encouraging that we've identified 90% of the pipeline to realise that 4.5-5 billion.

There's more work to be done to fill out that pipeline completely and there's a great deal more to be done in terms of actually realising that coming through the cost run-rate. But it's informed by our target of positive jaws. If we see a sustained weaker revenue environment, then clearly it's going to translate into having to take much more action on the cost line.

Chintan Joshi

On operational risk, Stefan Ingves said, 'We don't want Advanced Measurement Approaches (AMA).' From AMA to Basel 2.5 standardised operational risk methodology, do you have a sense of what that looks like for us? We'll look at what the new revised approach might do, but what about the old one? Do you see any inflation and what could that be?

Iain Mackay

Yes, we see some inflation coming through.

Jane Leach

There is still a lot of re-thinking being done around that. There was originally a standardised approach that was set out and then, in Stefan's speech, he was talking about actually bringing an AMA-type approach, a standardised approach, more together. That suggests some fairly fundamental re-thinking going on. It would be quite premature for us to talk about numbers at this stage.

Christopher Manners

On rate hikes and net interest margin. Looking back to 2011, you had a 2.5% net interest margin come down to about 2% net now. I know you have done things like selling the cards business and Brazil that may have a higher margin. If we are able to imagine that the rates do go up in December and whatever the curve prices in, where do you think you can get your net interest margin to, say, by 2017? Maybe you can't give a forecast for that, but maybe you can help us think about the building blocks to get there? What are the key moving pieces of that margin?

Iain Mackay

A base-lending-rate policy uplift helps our business model. We've got a deposit base off which we make not very much at this point in time and policy rate improvements clearly improve the overall net interest income and net interest margin of the Group. Rate lifts by the Fed and the Bank of England have been reflected across other currencies over the course of every year, actually.

You see policy rate movements and then you see the impact of that coming through, not only but most directly, balance sheet management income flow. The simple fact of the matter is, when we look at how our assets are underwritten and on the balance sheet, rate increases we see as providing very little if any stress from a customer affordability perspective. Therefore, we see rate increases as translating through to positive impact on net interest margin over time.

On a revenue base of $55 billion-plus of revenue, a 25 basis point lift in December by the Fed will not be noticeable in any given month or any given quarter. A 2% lift would be very noticeable across a year's earnings. The sensitivity around that we have provided in the annual reporting accounts and the interim report. As we refresh that each quarter, the numbers don't change a great deal because the overall composition of net interest earning assets doesn't change a great deal.

When you look across the US dollar, euro, sterling or dollar-related blocks, it doesn't change enormously from quarter to quarter or from year to year. It's a good thing for net interest margin, but in the grand scheme of things, if all we get is 25 basis points in December and nothing else for another year, it's not going to transform the profits of the Group.

Christopher Manners

Can I ask you about the other things we should be thinking about? Obviously, yes, the rate hike should help but then there is the competitive environment or changes in the mix that you're doing. Are there other pieces that should move the margin that we should be thinking about, either up or down, that are material or are the rates the one on which you're focused?

Iain Mackay

As you saw in these third-quarter numbers, the focus behind $290 billion of risk-weighted assets is the reallocation of the related capital to higher-returning businesses. It is coming out of lines of business which are either legacy or lower-returning, informed by changing regulation – particularly true within certain product lines within Global Banking and Global Markets, more importantly. That capital is being redistributed to businesses which generate higher returns. Those higher returns sit in markets like Asia but also sit in markets like commercial banking in the US. You see this coming through in terms of return on risk-weighted assets within the global businesses. We are slowly but steadily seeing overall return improvement coming through those global businesses. That is the focus of the team.

It's all very well to grow your balance sheet, but if you're not growing your balance sheet at a rate that is attractive from an overall-returns perspective, then, one, you're not getting paid for it because we're not getting paid for it. Again, that is a progressive effort that goes on week after week, month after month, quarter after quarter. The focus is on reallocating capital to those businesses, product lines and customers that generate better profits for us.

I'll use the US as an example. We went out and started rebuilding the Commercial Banking business in the US by using our balance sheet. That in and of itself is possibly gratifying for the RMs but not particularly gratifying for the CEO or the CFO, because it doesn't generate great returns in this interest rate environment. When you then go back to those customers and say, 'Look, you trade across four or five of the markets in which we're present and you've got a need of payments and cash management services and foreign exchange – and by the way you need to raise capital. Why don't we go out and do that for you?' and you can then demonstrate in the market which US, Asian or European markets you can do that in with good distribution, you get paid for that.

That's exactly what our Commercial Banking team in the US have done. They've started with balance sheet. They got a scolding for giving away money with insufficient returns and were told to go back and ask for the ancillary business. When they went back and asked for it, they got it. It's very tactical; it's very operational. But that's what the teams need to do.

Raul Sinha

On the headquarters review, the one thing I'm struggling to understand is, once you make a decision either way, is that done and dusted for three years or is that some kind of a rolling process where you will review your headquarters on a periodic basis?

Iain Mackay

This review is enormously important – and it's not about the next month, quarter, year or three years. This is about the next 25 to 50 years for the Group. As you could imagine, the range of information the Board needs to see and input they need to have from a wide range of advisors – from geopolitics through to tax through to legal constructs through to regulation.

This is an intense and detailed process. It would be entirely truthful to say that the board is taking this very seriously. You should read nothing more in Douglas's comments than exactly what he's said. There's a lot of work to be done. If another update is required, then you'll get it at the time of our annual results. What is implied by that is if we made a decision before that, we would clearly announce it.

However, there is clearly a lot of work to do in this space. Lots of people say, 'Is it about Brexit? Is it about the bank levy?' No, it's got nothing to do with any of that. It's got a great deal to do with where, strategically, the board believes the right place for the board to be headquartered for the next 25 to 50 years is.

Raul Sinha

This is different to your usual three-year review of headquarters.

Iain Mackay

Yes, I don't think we ever said this was part of the three-year review process. We have certainly said in the past that we will look at it every three years. I would have to say the bit we did every three years was, at best, compared to what we're presently doing, a cursory stroll around the possible implications of a change. What we're doing now is a roots-up review.