Edited transcript

Annual Results 2015

Conference call with investors and analysts

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Corporate participants:
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Stuart Gulliver, Group Chief Executive
Iain Mackay, Group Finance Director

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HSBC

Douglas Flint, Group Chairman

Good afternoon from Hong Kong, good morning to everyone in London, and welcome to the 2015 HSBC annual results call. I am Douglas Flint, Group Chairman. With me are Stuart Gulliver, Group Chief Executive, and Iain Mackay, Group Finance Director. Before we start I would like to say a word on behalf of the Board.

HSBC's performance in 2015 was broadly satisfactory against a backdrop of seismic shifts in global economic conditions. Given the uncertain revenue environment and the considerable reshaping necessitated by regulatory changes, it is notable that our three major businesses all generated higher global revenues. Stuart and his team have made good progress in executing the plans outlined at our Investor Day and the signs are positive that we are building a solid platform for the future. There is still a great deal left to do to adapt HSBC to new operating conditions and the Board maintains close scrutiny of progress in implementing the actions that management outlined in June.

Nonetheless, we are satisfied that we enter 2016 with a clear strategy and with much of the Group's required reshaping completed or underway. Sound management of capital, accelerated run-off of legacy books, shrinking the balance sheet in areas that can no longer support expanded capital requirements, and other RWA initiatives allowed the Board to approve a fourth interim dividend of 21 cents a share. This took dividends per ordinary share in respect of the year to 51 cents, which is a cent higher than last year.

I'll now hand over to Stuart to talk through the key points, before Iain takes a more detailed look at the performance.

Stuart Gulliver, Group Chief Executive

Our performance in 2015 demonstrated the fundamental strength of our business. Targeted investment, prudent lending and our diversified, universal banking business model helped us to grow revenue in difficult conditions, while simultaneously reducing risk-weighted assets. We grew revenue on an adjusted basis. Global Banking & Markets performed strongly and Commercial Banking grew steadily in spite of slower trade. Principal Retail Banking and Wealth Management also grew following a strong Wealth Management performance in the first half.

Our adjusted operating expenses increased as we continued to strengthen our compliance capability whilst also investing for growth. However, a combination of strict cost management and the cost reduction programmes that we started in the middle of the year helped us to keep second half costs flat relative to the first half, excluding the bank levy. Loan impairment charges were up by 553 million dollars in 2015 due to an increase in the fourth quarter, but remained generally low. This demonstrates again our prudent approach to lending and the benefit of our de-risking measures since 2011.

Our strong capital generation enabled us to increase the dividend while further strengthening the common equity tier 1 ratio to 11.9 per cent. We've made a good start implementing the actions that we announced in June. We are already 45 per cent of the way towards our targeted reduction in Group risk-weighted assets, and we have launched all of our initiatives to reduce costs. The investment we've made in strengthening our businesses in Asia helped to grow revenue faster than GDP in seven out of eight of our priority Asia markets. We have agreed to sell our business in Brazil and that deal remains on track. However we do not now intend to sell our Turkish business. After our Investor Update in June we received a number of offers for the business in Turkey, none of which would have been in the best interests of shareholders. We have therefore decided to retain and restructure our Turkish operations, maintaining our wholesale business and refocussing our retail network. This will provide better value for shareholders and continue to allow our clients to capitalise on our international footprint.

There's a lot still to do, but HSBC is better balanced, better connected and better placed to capitalise on higher return businesses than it was 12 months ago.

Iain will now take you through the numbers.

Iain Mackay, Group Finance Director

Thanks Stuart. Looking quickly at some key metrics for 2015. The reported return on average ordinary shareholders' equity was 7.2 per cent, the reported return on average tangible equity was 8.1 per cent; and on an adjusted basis, we had negative jaws of 3.7 per cent. Jaws for 2015 were significantly affected by difficult revenue conditions in the second half of the year. Adjusted revenue grew by 4.5 per cent in the first half of the year, but fell by 2.7 per cent in the second half. This left adjusted revenue growth of 1 per cent for the year against adjusted cost growth of 4.7 per cent. It's worth noting that the increase in adjusted operating expenses included a significant rise in the Bank Levy of 358 million dollars.

This slide takes us from reported to adjusted. Reported PBT for the fourth quarter includes a negative 773 million dollar charge for fair value losses on our own debt relating to credit spread, and nearly 2 billion dollars of other significant items. These include: 743 million dollars of costs-to-achieve in relation to our strategic actions; 337 million dollars related to UK customer redress, mainly PPI; a charge of 370 million dollars related to legal matters; a loss of 214 million on the sale of CML assets in the United States; and a 186 million dollar adverse debit valuation adjustment on derivative contracts. Adjusting for these items leaves an adjusted profit before tax of 1.9 billion dollars for the fourth quarter.

Bear in mind for next year that one item that will fall into this category will be the accounting loss on the Brazil transaction. We achieved a valuation of 1.8 times book on the Brazil business and will recognise an accounting gain on the sale before recycling approximately 2.6 billion dollars of FX reserves. However, once these reserves have been recycled, it will result in an accounting loss before tax of 1.8 billion dollars. On closing the transaction there will be an estimated 33 billion dollar reduction in risk-weighted assets and a positive pro-forma impact on our Common Equity Tier 1 ratio of around 60 basis points. We don't treat the Bank Levy as a significant item as it's a recurring cost. You'll find more details on these adjustments in the appendix. We'll focus on adjusted numbers for the remainder of the presentation.

The drop in fourth quarter profits was mainly driven by higher loan impairment charges. Loan impairment charges were up 634 million dollars on the fourth quarter of 2014. I'll go into that in detail on the next slide. Revenue grew in all three of our main global businesses. Global Banking & Markets revenue was up 16 per cent on last year's fourth quarter, and Principal Retail Banking & Wealth Management and Commercial Banking were up by 3 per cent and 1 per cent respectively. Group revenue was down by 1 per cent overall. The drop in revenue in the quarter came from 'other', which was down by 536 million dollars, or 31 per cent. This was mainly due to two things. In the fourth quarter of 2015, 'Other' included losses from hedging ineffectiveness, compared with gains in the previous year. Also, in the fourth quarter of 2014, there was a gain from the disposal of gilts relating to intra-group funding which didn't re-occur in 2015. Operating expenses were up 2 per cent on Q4 2014, but this was entirely due to the Bank Levy. Excluding the Bank Levy, costs were lower than last year's fourth quarter. This is an important accomplishment. It's also worth noting that our second half costs were in line with our first half costs.

On this slide, we break down loan impairment charges between personal, wholesale and other credit risk provisions. Before we get into the detail of the fourth quarter, it is worth noting that loan impairment charges were up for the full year from 3.2 to 3.7 billion dollars. The main driver was an increase in charges on personal lending of 341 million dollars, mainly in Brazil and the United Arab Emirates. It also reflected lower net releases on available-for-sale debt securities. Charges on wholesale lending reduced by 123 million dollars across the year. There was an overall increase in loan impairment charges in the fourth quarter of 2015. The biggest single factor here was an increase in specific and collective charges in the oil and gas sector. I'll cover that in detail shortly. The charge in the fourth quarter also included specific charges related to a number of unconnected local factors in a range of countries and individual sectors.

We took just over 400 million dollars of loan impairment charges in relation to the oil and gas sector in the fourth quarter. Most of that charge was collectively-assessed, reflecting our expectation that energy prices will stay low throughout 2016. We have modelled this at a price of 30 dollars a barrel. In all, the sector accounted for approximately 500 million dollars of loan impairment charges in 2015. At the year end, our overall oil and gas exposure was 29 billion dollars, which represents 2 per cent of our wholesale drawn risk exposures. This is a 5 billion dollar reduction versus the prior year. Credit quality in the book remains robust: 95 per cent of our exposures are rated as Credit Risk Rating one to six. Nevertheless,

we continue to monitor this sector closely and we'll look to manage down exposures further where appropriate.

Lastly on this topic, four points worth noting. First, the increase from the third to the fourth quarter was not caused by a deterioration in Asia and China, but a number of idiosyncratic issues in a range of regions, countries and sectors. Second, loan impairment charges for 2015 remain low compared to previous years. Third, our coverage on our wholesale lending for 2015 – that is impairment allowances as a proportion of impaired loans – is in line with the recent historical average. And fourth, as you can see, our lending portfolio is well diversified by both geography and sector.

Turning to the full year, adjusted profit before tax fell by 1.6 billion dollars, or 7 per cent, in 2015. This was mainly due to higher operating expenses. As you can see, there is a good balance between our global businesses in terms of their contribution to Group PBT. We have purposely managed the business to ensure diversity as an antidote to volatility, and this remains a focus of our strategy. Over the last few years our global businesses have worked in a complementary fashion. It's a valuable and important dynamic.

Regionally, the lion's share of our profit derives from Asia, which reflects our advantages in the region as well as the opportunity for growth that we see there. On a regional basis, PBT was up slightly in Asia and Latin America, but fell in Europe, North America and Middle East & North Africa. The decrease in PBT was largest in Europe, where revenue growth of 136 million dollars was over-taken by a cost increase of 1.2 billion dollars. Excluding the Bank Levy, costs in Europe rose by 853 million dollars from investment in regulatory programmes, compliance and staff costs. These also include HQ costs. In North America, there was a reduction in PBT from the continued wind-down of our US CML portfolio as well as higher loan impairment charges in the principal US business and Canada.

Revenue increased across all of our businesses in Middle East & North Africa, and costs increased by broadly the same amount. Loan impairment charges of 299 million dollars in 2015 versus a release of 4 million dollars in 2014 were the main driver in reduced profits for the year. PBT in Asia was 167 million dollars higher as revenue grew in all four global businesses. Global Banking & Markets was the star performer with a revenue increase of 369 million dollars. Commercial Banking was up by 219 million dollars, while Retail Banking & Wealth Management rose 278 million dollars following a strong first half performance. Some of this growth was offset by a 742 million dollar increase in costs, particularly from wage inflation and investment in regulatory programmes and compliance, as well as investment to support business growth. Latin America PBT was up by 93 million dollars due to higher revenue and lower LICs.

Looking at revenue in more detail – adjusted revenue rose by 1 per cent thanks to growth in our three main global businesses. Global Banking & Markets performed well, with increases in all but one of our client-facing businesses. Equities and Foreign Exchange were especially strong as increased volatility resulted in higher client activity. This was achieved while simultaneously reducing risk-weighted assets in Global Banking & Markets. Commercial Banking revenue grew by 3 per cent, with strong performances from Credit & Lending and Payments & Cash Management. Most of this growth came from Hong Kong and the UK.

Principal Retail Banking & Wealth Management grew by 2 per cent, helped by a strong increase in investment distribution revenue in Hong Kong in the first half of the year. Wealth Management revenue in Europe also grew by 21 per cent. Global Private Banking revenue fell by 6 per cent as we continued to de-risk the business, although revenue increased in Asia due to higher client activity in the first half. 'Other' revenue included the themes for Q4 that I explained on slide 5, as well as a reduction in the dividend from the partial sale of our holding in Industrial Bank.

Adjusted operating expenses were 1.6 billion dollars, or 5 per cent, higher than in 2014. This was due to wage inflation in Latin America and Asia, continued recruitment to support business growth, and investment in regulatory programmes and compliance. The bank levy was also 358 million dollars higher than 2014. Looking at costs on a half-by-half basis you can clearly see the impact of the actions we've taken to manage down costs. All of our cost-reduction programmes are now underway and our FTE number is back to the level it was in early 2014. Whilst this shows good early progress, we will continue

making cost savings through 2016 and ’17 to offset both inflation and investment in business growth - so there is still a great deal to do.

This slide shows our end-of-2017 cost target rebased to account for currency translation and the sale of Brazil. As Stuart mentioned earlier, we are retaining our Turkish business. We’ve adjusted for this in the re-based target, which is now 30.5 billion dollars.

Turning to capital, the Group’s Common Equity Tier One ratio was 11.9 per cent on 31 December, compared with 11.8 per cent at the end of the third quarter. Continuing progress on risk weighted asset reductions in the fourth quarter enabled us to grow our Common Equity Tier One ratio. This ratio increased by 80 basis points over the course of the year as a result of capital generation from profits net of dividends, and risk-weighted asset initiatives. We will come back to RWA initiatives shortly.

This next slide shows our Group return metrics. The return on average ordinary shareholder’s equity for the year was 7.2 per cent. This is marginally down from last year’s 7.3 per cent, due in part to the higher bank levy. The reported return on risk-weighted assets was 1.6 per cent, compared to 1.5 per cent in 2014. It’s worth remembering that the risk weighted asset figure is an average of recent quarters and doesn’t yet fully reflect the full benefits of our risk-weighted asset reduction programme. We continue to work towards an adjusted return on risk-weighted assets of greater than 2.3 per cent by 2017.

I’ll now hand back to Stuart.

Stuart Gulliver

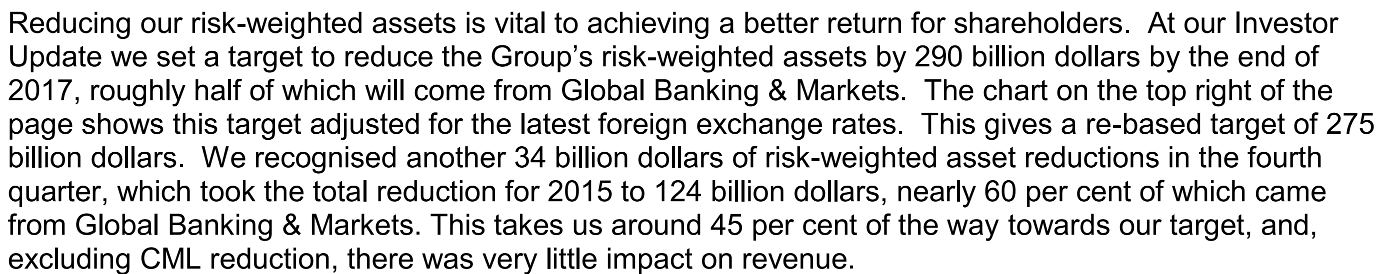
Thanks. This slide provides a summary of our progress in the eight months since our Investor Update. There’s a lot still to do to hit our targets but we’ve made a good start. I’m going to cover risk-weighted asset reductions and revenue growth from our international network on the next two slides, so I’ll concentrate on the other actions here.

We’ve reduced our footprint to make the Bank simpler and leaner. We’re now present in 71 countries and territories, down from 88 when this team took over in 2011. The agreement to sell our Brazil business to Banco Bradesco has received central bank approval, and awaits approval from the Competition Commission. We also have regulatory approval to retain a small presence in Brazil to serve our large corporate clients. Our US and Mexico businesses remain a work in progress. We grew revenue in both businesses in 2015, in part from better collaboration between global businesses and an increase in revenue of more than 30 per cent from cross-border business across NAFTA. Retail Banking & Wealth Management in Mexico also grew by 7 per cent on an adjusted basis, and we grew market-share in cards, mortgages and personal loans. We also improved cost efficiency in the principal US business by consolidating data centres and moving to lower-cost office locations.

As Iain has already said, we’ve made good progress on operating expenses. A lot of what we’ve done so far actually reflects very tight cost management. All of our cost programmes are now underway and you will see the impact coming through in the next few quarters.

We’re gaining momentum in our Asian businesses and we achieved growth in excess of GDP in seven out of eight priority markets in Asia. Since the start of 2015 we have advised on four of the five largest M&A deals out of Hong Kong and China. We were the lead adviser on Chemchina’s 43 billion dollar acquisition of Syngenta, which was the largest outbound M&A deal coming out of China. We also acted as Financial Adviser on the restructuring of Cheung Kong and Hutchison Whampoa, the largest deal ever concluded in Hong Kong and the largest Asia-Pacific deal since 2001. We also retained our leadership position in Asian Debt Capital Markets and entered the top 3 for Asian M&A for the first time.

We continue to invest in the Pearl River Delta to build a scalable business and capture growth. As we reported at Q3, the majority-owned securities joint-venture that we agreed will allow us to engage in the full spectrum of securities business in the country. We expect regulatory approval this year. Our enhanced capabilities in ASEAN helped to drive revenue growth of 5 per cent year-on-year. Asset Management in Asia continues to grow, and we increased assets under management by 13 per cent in 2015. Finally, we extended our leadership position in renminbi business and grew revenue by 3 per cent in 2015.



Reducing our risk-weighted assets is vital to achieving a better return for shareholders. At our Investor Update we set a target to reduce the Group's risk-weighted assets by 290 billion dollars by the end of 2017, roughly half of which will come from Global Banking & Markets. The chart on the top right of the page shows this target adjusted for the latest foreign exchange rates. This gives a re-based target of 275 billion dollars. We recognised another 34 billion dollars of risk-weighted asset reductions in the fourth quarter, which took the total reduction for 2015 to 124 billion dollars, nearly 60 per cent of which came from Global Banking & Markets. This takes us around 45 per cent of the way towards our target, and, excluding CML reduction, there was very little impact on revenue.

The savings included the continued reduction in Global Banking & Markets legacy credit and the US run-off portfolios, which together reduced risk-weighted assets by 30 billion dollars. A further 12 billion came from the disposal of our shareholding in Industrial bank. Refined RWA calculations, process improvements and exposure reductions in Global Banking & Markets and Commercial Banking contributed an additional 80 billion dollars in savings. We're currently ahead of where we expected to be at this point. We continue to focus on optimising our capital and we're confident of hitting our target.

We are working to grow revenue from our international network faster than GDP. This slide shows not only our progress, but also how important our network is as a generator of growth. The investment that we've made has helped to increase revenue from international clients by 5 per cent in 2015. Our Transaction Banking products capture value from trade and capital flows and are therefore central to our strategy. We increased transaction banking revenue by 4 per cent in 2015, helped by strong performances in Payments & Cash Management and Foreign Exchange. Payments & Cash Management also increased average deposits by 8 per cent in 2015.

Securities Services, which plays an important role in our renminbi business, grew by 7 per cent, and Global Trade & Receivables Finance revenue dropped by just 1 per cent, despite a decline in commodity prices and slower world trade. We increased business synergies by around 600 million dollars, or 6 per cent, including a 7 per cent increase in revenue from the sale of Payments & Cash Management products to Global Banking & Markets customers. Total business synergy revenues were equivalent to a fifth of total revenues for the Group in 2015. The growth from our international network continues to be a significant point of strength.

I'd like to leave you with five points. First, the current economic environment is creating a great deal of uncertainty, but this is a strong and robust business. We are a well-capitalised and highly liquid bank, with an advances to deposits ratio of 72 per cent and a leverage ratio of 5 per cent. We are diversified and balanced with a track record of resilience and a history of stable earnings.

Second, economic growth remains robust in a number of markets and there are plenty of revenue opportunities available to us, particularly in the areas that we've been targeting for growth. To give you a few examples: the Juncker Plan in Europe and the Belt and Road initiative in China will boost infrastructure financing; major trade agreements like the Trans-Pacific Partnership should offer stimulus to trade; and the COP21 agreement in Paris will lead to a major expansion of the Green Bond market, in which we're already a market leader. Because of that, we will continue to invest to grow the business.

Third, we are concentrating on achieving our cost target of 4.5 to 5 billion dollars of cost savings and we remain focussed on achieving our 2014 run-rate by the end of 2017.

Fourth, at HSBC we have already completed most of our restructuring. We have a clear strategy and our over-riding priority is the delivery of our nine remaining strategic actions.

Finally, and as we've said before, prospective dividend growth remains dependent upon the long term overall profitability of the Group and delivering further release of less-efficiently deployed capital. Actions to address these points are core elements of the Investor Update provided last June.

The balance sheet strength that I've described enables us to manage the business for the long-term in accordance with our strategy. In the meantime, our diversified universal banking model, low earnings-volatility and strong capital generation give us strength and resilience that will stand us in good stead.

We will now take questions.

Chintan Joshi, Nomura

Good morning. Can I start with revenues? I see that your underlying revenue is $57.8 billion for 2015. What I was hoping to get from you was an underlying base by excluding all the things that you're running off, so Brazil, Turkey, GBM, CML, CMB, all the items that are going to be out by 2017. What is the revenue contribution from that? I get roughly a number of about $52 billion from all those items excluding Brazil, Turkey.

Iain Mackay

As you could imagine, there's quite a few moving parts in that. So if you think about the CML impact, there's about a $300 million down every year as we run this portfolio off, and if you look back over the last two or three years that's pretty much the ballpark. We can certainly give you the base numbers around the revenue generation and CML. I think it's probably better that we do that either offline or we'll do some prep around that so that we can share with all of you at the analysts' call next Monday. The other obvious thing that's in there is Brazil, and I think you've already got the Brazilian numbers but we'll gladly share them with you again. And then the last significant item is the legacy run off within Global Banking and Markets. Those are the three key elements in terms of focus around disposals of businesses as well as run-off of legacy business, so we'll do a short three-liner for you on that one and share it with everybody next Monday at the analysts' meeting, okay?

Chintan Joshi

Okay, thanks. The second one is on RWA. So your target is now $275 billion, but it does not include the sale of Turkey now. So I'm guessing you've got $13 billion odd from somewhere else, because you haven't changed the RWA run off target. I was just wondering what that would be. And also you grew RWAs by $35 billion because of business growth, from your slides. Is that the kind of run rate we should expect in this kind of market, i.e. macro-level change, is that what we should be expecting?

Iain Mackay

On the $13 billion as it related to Turkey you're absolutely right, Chintan. We're committed to the $290 billion, $275 billion on a constant currency basis. As you can imagine, as the teams dig in to the various aspects of capital allocation within the group we're finding some incremental opportunities to economise in that regard. So we're fairly confident that we'll hit the $275 billion, excluding the fact that we're retaining the Turkish business.

In terms of redeployment of this, I think, as you can probably anticipate looking at overall levels of activity in the fourth quarter, I think one of the things that will remain constant within HSBC is the risk appetite for the Group in credit underwriting standards, and market risk appetite within the Group. So as we release this capital, which we're really confident in terms of accomplishing, the rate at which we redeploy – which, by the way, informs the very reason for taking these risk weighted assets out – is to redeploy it into business that generates profits at and above the hurdle rates that we've set for global businesses that takes us back to achieving that return on equity of greater than 10%.

What we are not going to do is redeploy capital that does not hit those thresholds. So although we had $35 billion back in the fourth quarter, which was encouraging, I don't think we're going to sit here and predict for you a particular growth rate on a quarter by quarter basis, because we will absolutely be informed by a propensity throughout the business that triangulates back to the return on equity that we've set for the group.

Chintan Joshi

Thank you. And final one on costs, costs grew 5% on a current currency adjusted basis. You've obviously got – given us goalposts for thinking about 2017, 2018. I was wondering if you could help us think about the underlying cost run rate for 2016. You know, should we expect all these measures that are coming about to help your run rate in 2016 itself, or are there regulatory cost headwinds that will offset those and this is more a 2017 improvement?

Iain Mackay

I think, Chintan, what we've said previously in this, which remains consistent today, is that we've got continuing investment lined up across what we've got to do in regulatory programmes and compliance. There's still a lot of work for us to do in that regard. Part of that obviously fits in to the continued deployment of what we need to do in global standards, and although we will absolutely see the benefit of the savings programmes that we've got underway, we do expect to see incremental costs coming through in 2016, as we said before, and we'll start seeing the accomplishment of that exit rate coming through. So that'll be expected in the latter part of 2016, but more emphatically in 2017.

And what we are going to try and do, and certainly took a step over the last couple of quarters in this regard, is provide you with sufficient disclosure so that you understand the investments we're making, if you like the cost to achieve, the actual money we're spending on achieving those outcomes, the investment that we're making in those programmes, and then obviously getting to the underlying run the Bank and change the Bank costs that sit there. So certainly as we look at the run the Bank costs on a quarter to quarter basis we would certainly expect to see some of the benefits coming through in 2016, but I'd simply caveat that by the continued investment in global standards and other regulatory programmes and compliance.

Alastair Ryan, Bank of America

Two related questions please. The net interest margin shaded down, by the looks of it, in the fourth quarter, and clearly the environment is becoming less helpful, with rates everywhere under pressure. Is your previous sense that the margin had pretty much stabilised still valid? It feels like external conditions have deteriorated.

And secondly, on deposits another good deposit performance, which is something that HSBC always does well but if rates stay this low is there a portion of the deposit base that doesn't work for you anymore? I know it's not at all natural for you to start pushing away deposits, but is there a point in the rates cycle at which it becomes necessary to do that?

Iain Mackay

Net interest margin remained very stable and, when you go through the major operating subsidiaries of the group, it's equally the case. If we look at NIM on an overall group basis in the fourth quarter, it came off 3 basis points in total from 2014 after the effects of currency translation, the CCA and a tax accrual release in the US. When you look at the individual businesses that contributed to that 3 bps deterioration, 2 bps were in Europe, principally in the UK on the UK mortgage book, where we've certainly seen some margin compression overall; and then secondly on North America.

Overall, net interest margin is very, very stable. There's a little bit of competitive pressure coming through the mortgage book in the United Kingdom and then the deposit base in the US. One of the other contributors to that is the further deterioration in CML in the US, and that's just a natural runoff of the portfolio there.

Stuart Gulliver

You were asking if there's a point at which we would turn away deposits. It kind of obviously self-evidently depends on which currency we're talking about and, therefore, which interest rate we're talking about. We continue to operate in a number of countries where actually interest rates are very positive, so it isn't as acute as it might be for some of our competitors. In those currencies, and this is particularly the euro, we obviously have started with banks and non-bank financial institutions to discourage them to deposit with us.

Iain Mackay

There's one other aspect to this, which is an important one, Alastair, which is, when we look at overall balance sheet optimisation, one of the questions that I expect that one of you will ask, either over the duration of this call or next week, is around issuance of total loss-absorbing capacity instruments. Given that we have a significant programme of issuance to do for compliance in that regard, again layering in exactly Stuart's comment, we're going to look across the balance sheets of the group and look at where,

in actual fact, the deployment of that total loss-absorbing capacity into that business is a better funding mechanism for some of that business than deposits. Accordingly, that would inform some of our actions with respect to deposits in some of those jurisdictions, so there's the introduction of another moving part in this equation and that is trying to ensure that we come up with a reasonably efficient deployment off TLAC to the various operations of the group.

Stuart Gulliver

The plan is to issue TLAC at the holding company level and then stream it down into the operating subsidiary balance sheets.

Raul Sinha, JPMorgan

If I can have two questions, please, the first one is just to continue on the revenue point. I think Iain mentioned in his prepared comments that your revenue, at a group level on an adjusted basis, was down about 2.5% in the second half of the year. Most of the revenue flow that you saw last year actually came in the first half, 4.7%, which was actually quite a supportive macro-market backdrop. In the context of that and given that you've seen a little bit of a downtick in the second half of the year, I was just wondering if you can talk about your start to the year and how Q1 seems to have evolved, given it appears quite slow to us in the market we look at. Secondly within that, just your confidence around the cost measures that you've previously outlined: do you still think that you will be able to deliver positive jaws, as we move through this year, given the sort of revenue environment that we're in? That's the first question. The second one I've got on BoCom, I can see the value in use has gone up to $17 billion now and you're carrying value is $15 billion, whereas obviously the fair value of the market prices is just below $10 billion. I was just wondering if you could talk to us a little bit about how much further you think the value in use can continue to rise and if, at some point, you would be hitting the point at which you might have to reverse the contribution.

Iain Mackay

On the revenue front, if we look at the first six or seven weeks of activity in 2016, broadly speaking, commercial banking is pretty well supported, reasonably optimistic outlook in many of the markets. Obviously the overall environment is probably a bit doom and gloom-ish but, when you look at the numbers coming through, they're reasonably constructive on the CMB front. They're reasonably constructive on Retail Banking and Wealth Management. Certainly in the wealth management front in Asia, it's a little bit slower than it was in the first quarter of last year, but again reasonably constructive. As you would fully expect in Global Banking and Markets, given some of the activity we've seen in the marketplace, the markets business has certainly been facing some headwinds in January and the first couple of weeks of February. Global Banking broadly speaking is as expected but, in the round, I certainly wouldn't like to try to project out the whole year based on the first six or seven weeks of trade, but Commercial Banking, Retail Banking and Wealth Management, and Global Banking, broadly speaking, were fairly supportive.

In terms of that informing cost actions, where we are very, very focused as a team is hitting the $4.5 to $5 billion of cost saves and the exit run rate that we set for 2017. As you can probably imagine, to take $4.5 to $5 billion of costs out of the business in two and a half years is a significant undertaking. There are a lot of programmes up and running. As you can certainly see from our fourth-quarter and second-half numbers, we're getting traction on those numbers. It's actually the first second half where we've seen costs in line with the first half for as long as I've been doing the CFO job. It's the first time in the fourth quarter that costs haven't increased significantly on the third quarter, for quite some time. So that's encouraging but there's clearly a lot more to do.

In terms of that resulting in positive jaws, if there's a reasonably supportive revenue environment, then that gets us there. If the revenue environment is pretty hard for the rest of the year, it really becomes a question of managing this business for the long term and making sure that we continue to invest in the revenue-generating capabilities and make sure that we've got the capability to meet our regulatory and compliance obligations in an efficient manner. The first task is to get the $4.5-5 billion out. As part of that, hit the 2017 exit rate equal to the 2014 run rate and then, all being well, a reasonably supportive revenue environment should see us to positive jaws. Again, it's too early in the year for us to lay that out

super clearly for you and, hopefully by the time we get to the first half, we'll be able to have a more robust conversation around exactly what the year holds against that particular metric.

On BoCom, the driver of the change in the value in use, one of the things that BoCom is moving towards is the implementation of internal ratings-based models for the evaluation of regulatory capital and that is one of the inputs to our discounted cash flow value-in-use model. That reduces, if you like, the RWA concentration intensity and that is one of the key factors that resulted in an uptick, in terms of the overall value in use for the group, so a reduction in the capital-carrying costs.

The other consideration, which is probably more important, is that our carrying value continues to increase as we recognise our share of net assets, as BoCom continues to be accounted for under the equity method of accounting within the business. What I can say categorically is, based on how this business is treated for regulatory capital purposes, regardless of whether or not we continue to recognise our share of earnings through the equity method of accounting, there is absolutely no impact on the capital of the group. The risk-weighted assets associated with BoCom are consolidated on a proportional basis for regulatory capital purposes and we recognise the cash dividend, which is not particularly significant, which we receive from BoCom as part of the reduction in carrying value.

In terms of having any reduction in recognition of our share of net assets from BoCom, it will not have an adverse effect on how the capital weighting is considered within the group and it has no impact on cash flows either. Although it's something that we're monitoring closely, perhaps value of use, although it is highly relevant, how the carrying value progresses is probably the thing that is more likely to determine whether or not we recognise an impairment on this, whether that's in 2016 or a later time.

Raul Sinha

The fair value has got no bearing, Iain, on either of those two numbers.

Iain Mackay

It really doesn't. It obviously has a bearing in terms of being an indicator that we have to consider, when it comes to testing this for impairment. Where the market value is sitting up around $17 billion, we clearly wouldn't be having this consideration but, because it is where it is, we assess this investment for impairment on a quarterly basis. The methodology that we've used in this regard is highly consistent although, as you can imagine, Raul, we revisit the assumptions, the quantification and parameters for those assumptions on a quarterly basis and ground them by reference to external benchmarks. This is clearly a cash flow model that is built internally, but the inputs to it are validated based on external benchmarks.

Ronit Ghose, Citigroup

I had three questions I wanted to ask. The first one's on Brazil. You sounded very confident that the deal, the transaction, is on track. I was just wondering if you could give us some colour on closing times, given the anti-trust investigation. Originally you'd be hoping for, I think, Q1 but officially were saying first half. Is this still a first-half close or could this slip into second half? That's my first question.

My second question is thank you very much for the greater disclosure on commodities, but I was just wondering if you could share some more on the oil and gas exposure, particularly slide 7. Most of your exposure, 95% of your exposure, you've put into the six rating buckets. Can you give us any further granularity of how much would be, say, investment-grade versus sub-investment-grade, or how much would be in higher CRR numbers?

The third question is, given the news on Friday in the UK about the upcoming Brexit referendum, is that material enough to reopen the head office domicile question?

Stuart Gulliver

On Brazil, basically the timetable is broadly in line with the guidance we provided when we announced and, yes, we still think that this transaction will close in the first half of this year, so by 30 June.

On the oil and gas stuff, I'll kick off and Iain might want to jump in. What I can tell you is that in Global Banking and Markets 50% of our exposure is to national oil companies, 18% is to the integrated oil companies, so the big oil majors; 13%, to the independents; 9%, to oil services; 5%, infrastructure; 4%, to traders; and 1%, to refiners. It's a pretty strong book actually.[1].

Iain Mackay

The only thing I'd add a little bit there, if you think about breaking it down into external ratings, almost 60% of the book is high investment-grade, so AAA at one end of that scale down to BBB-. Then we've got about 35-36% of the book that is BB+ to B. When we think about it in that context, we've got pretty high ratings, from an overall credit quality perspective, for more than 90% of the book.

Stuart Gulliver

Remember as well that the loan impairment charges that we raise were mostly collective loan impairment charges, so they're anticipating a worsening in the portfolio. They are not specific to individual credit.

Iain Mackay

In terms of how we've taken that, may I call it – well, I'd better not call it a general provision – but an incurred but not reported provision against that $30 per barrel, it's booked into the legal entities and businesses where we obviously have oil and gas exposures. The principal areas there are the United States, Canada, the United Kingdom and then the Middle East and North Africa.

Ronit Ghose

The generic provisions are across all the legal entities, but the individual provisions would be largely North America-focused.

Iain Mackay

No, actually the individually assessed credits against which we've taken provisions over the year as a whole, as well in the fourth quarter, have started within the United Kingdom, the US, Canada and the Middle East.

Douglas Flint

On Brexit, where we had the opportunity to respond to that question last week, we indicated that, while our own economic research is very clear that Britain's better position is to be within a reformed Europe, and therefore we support Britain staying within Europe, it had very little impact on the domicile of the holding company, so it wouldn't reopen the debate. It's an issue potentially for the non-ring-fenced bank, depending on whether Britain would vote to leave, but it doesn't have an impact on the domicile decision. Remember that the holding company has two very major subsidiaries respectively in the UK, but also a very major subsidiary in France, so we really have a very major operation within the Eurozone. It could have an impact on the non-ring-fenced bank, but it would not reopen the domicile decision.

Ronit Ghose

That's clear, so nothing for the holding company, but maybe some GBM jobs move.

Stuart Gulliver

Again, it would depend, to be honest, on what the various terms were of the UK leaving, if indeed the referendum was for the UK to leave, so to what extent passporting details were negotiated. Obviously that itself would probably take some time to do, so there would be a period of uncertainty, which almost inevitably means that those activities that are regulated under a European umbrella would probably have to relocate to a continental European location, which in our instance would be Paris. As I say, it's that we'd need to foot out when we know what the actual facts are. As Douglas says, it has no impact on the

[1] *The percentages quoted are based on the Exposure at Default measure. For the full book (i.e., including GBM and non-GBM exposures), state-owned oil companies comprise 41% of the Group's $29bn of drawn risk exposures.*

domicile of the holding company; it's very specifically about the non-ring-fenced bank and the detail of that, we'd need to wait to see about what actually the terms were of any exit, if indeed an exit were to come about.

Ronit Ghose

Great, thanks and thanks for the extra oil and gas granularity. It is useful, thanks.

Chira Barua, Sanford Bernstein

There are two quick questions, one on dividends. The dividend guidance is pretty clear; you said progressive. At the same time, there's a complication in terms of capital release from low-yielding assets or non-strategic assets and your long-term profitability. If you do the simple maths, it almost seems like, if you want to give a progressive dividend, market conditions have to change significantly, otherwise you'll end up paying out of capital. Can you help me just understand how you're thinking about the 2016 dividend right now, given the current market conditions, or is progressive much more longer term?

Iain Mackay

Again, as the words both in the Chairman's statement as well as what we've told you today, we've always viewed dividends in the longer-term context. It's informed by the capital strength, which comes from profit generation as well as the efficient management of our capital, around which you've seen a lot of very focused activity over the course of the last couple of quarters. It's obviously informed by the profitability that we can generate on a year-by-year basis, but that profitability simply informs the strength of our capital base overall.

When you then think about the risk-weighted assets that we are releasing in under-performing businesses, I'll go back to one of my earlier answers. The extent to which we redeploy that will be informed by our ability to redeploy it in business that generates profits consistent with the thresholds that we've set, by global business, by line of business, which takes us back to improving return on equity above 10%. If, in actual fact, we find ourselves in an environment for some period of time where the ability to redeploy that capital profitably is muted to some degree then, yes, we will end up with higher capital ratios and conceivably capital ratios that are well beyond that which we would reasonably require in any regulatory environment.

If in fact, at that point, we find ourselves paying a progressive dividend out of capital resources, then we would pay our dividend out of capital resources. If we operate in that environment to sustain a higher pay-out ratio, it's not necessarily something that would concern me. If we were in an environment where we were re-investing that capital, then clearly we would want to see the rate at which we pay our dividends to fall back into the region of that 40-60% pay-out ratio, but this is a long-term view. We're not informing dividend payment, in any given year, based exclusively on what will happen in that year. Certainly what we've done in the last two years informs exactly that.

Chira Barua

Iain, to that extent, the whole capital thing in the US, given that you passed CCAR last year, how should we think about capital coming back from the US, because that's been dead capital for some time now?

Iain Mackay

Great question, Chira. When we look at this, just as we talk about capital efficiency across the whole of the group, certainly there are fairly significant goals in place for Pat Burke and the US team. We see having passed CCAR as a big positive, but when you then go back to the strategic actions, one of the strategic actions is improving the profitability of our NAFTA businesses. Two of our least-well-performing businesses, in terms of profit generation, are the US and Mexico, informing the strategic actions.

One of the things that we believe we've got to do, not only to convince ourselves that we should be taking capital and dividends out of the US, but to convince our regulators, is to not only address some of the compliance concerns that we have in the US – so we've got a number of consent decrees in place that are well publicised. We've got very specific actions in place to get those resolved and out of the way, over the course of the next 12 to 18 months. We believe that's an important obstacle to cross. In the

same timeframe, it's to improve the overall sustainability, diversification of profits within the US business, obviously to continue to be successful in passing the CCAR tests set by the Federal Reserve board and then, off the back of that, create the basis on which we're able to extract capital dividends from the US, if not in 2017 certainly in 2018.

Chira Barua

Just one more question – a brief outlook on Hong Kong. House prices have started to roll off. I've seen loan growth being kind of sluggish, risk still very, very low numbers historically. How should we think about Hong Kong this year, across all the business groups?

Stuart Gulliver

We're looking for Hong Kong GDP to be about 2%, 2.2%, 2.3% growth this year, which is still reasonable. Consumer spending growth is slowing. The labour market's actually quite tight. Obviously there's an impact on Hong Kong from less tourism from mainland China. The property market here historically has phenomenal volatility, but very low default rates. The banking system is very heavily capitalised. The loan to value of our book is very, very conservative. Sitting here, we don't have elevated concerns about LICs from residential real estate lending here in Hong Kong.

Iain Mackay

On page 8, Chira, we provided in a couple of our little callout boxes a little bit more detail on the Hong Kong mortgage book. There's US$61 billion there. LTV ratio is currently 29.3%. Buy-to-let within that portfolio is 15%. Defaults and delinquencies within that book are absolutely rock bottom, virtually zero, so overall that book continues to be in pretty good shape. In terms of residential rentals, the market's holding up reasonably well.

Chira Barua

You're not worried about commercial banking. Their impairments are almost zero.

Iain Mackay

They're very, very low, very diversified, not necessarily underwritten on specific development properties, but underwritten giving a clear view to the wider resources of the sponsoring organisation. Again they're organisations in Hong Kong that this bank has operated with for decades, in many instances, and have longstanding relationships. Again, it is a well underwritten, well collateralised book of business, and well diversified across different sectors of commercial real estate.

Martin Leitgeb, Goldman Sachs

Two follow-up questions from me, please, one on loan growth or revenues and one on capital. Firstly on loan growth, could you confirm on a constant currency basis what loan growth was for the bank as a whole, in the fourth quarter? I was wondering if you could give us a steer on how we should think of loan growth in the core franchise, so retail banking, wealth management and commercial banking, over the next one or two years. Should we assume that loan growth here would be roughly in line with GDP or should we assume that other redeployment trends mentioned earlier could wait a little bit more on that?

The second one is on capital. I think in the annual report you state that you expect or the FPC has guided that the Pillar 2A buffer could reduce once the RWA efficiencies are corrected. Could you give us a steer on how your market risk-weighted assets would increase according to the final draft of the fundamental review of the trading book paper from the Basel Committee, just to get a sense of how much the impact here could be on Pillar 2A? Would you expect that change to happen only in 2019 or would that be a gradually phased in change? Thank you.

Iain Mackay

Loan growth overall in the fourth quarter was about $8 billion. That was mostly within the European business and in North America, with a slight decline in Asia, mostly in large accounts within Commercial

Banking and GB&M, that being actually consistently the case in terms of growth, as well as reductions. It's been net in the book with $8 billion in the fourth quarter, so a little bit underneath 1% overall. In terms of that necessarily being a reflection of what we would anticipate being able to do, I'd go back to my earlier comments on revenue. I think it's probably a little bit too early in the day to read too much into what that mean for the year as a whole.

On a fundamental review of the trading book, at this stage, you're going to get the same answer from me as you did at the third quarter. Also, there is a range of possible outcomes. Where we might fall within that range of outcomes remains still really quite uncertain. Were we to be successful, as an organisation, in accomplishing an internal markets assessment view on every desk within the Bank and all of those models could be implemented and approved by the PRA on a timely basis – then at least based on the most recent outcome – the likely impact is something we would feel very confident about being able to manage within our risk-weighted asset savings targets.

It's certainly what is front of mind from Samir's perspective. Were the standardised approach to be applied across the book, then the range of possible outcomes becomes much, much wider. Until we're further down this path and until we've had the opportunity to do, frankly, a much more granular analysis of the book with a much clearer representation from Basel as to what the final outcomes are, I'm afraid you're going to have to wait for a little bit more detail on that one.

David Lock, Deutsche Bank

Three questions from me, please. The first one is coming back on the cost reduction and revenue interplay. If we do see a kind of structurally low-revenue environment, I'm just wondering whether you see any ability to revisit the cost targets going on, particularly within the investment bank. Clearly, if the revenue weakness is more concentrated there, is there any kind of cost flex we could expect to come through from there?

The second question is on the risk-weighted assets reduction you've done in GBM. Remembering back to the June presentation, I think I'm right that you said around $400 million of revenue would be impacted from the RWA reductions you were targeting. Obviously, you have achieved a lot of that this year. I wondered whether you could update on the run-rate impact on revenues from those risk-weighted asset reductions.

The third question is this. For impairments in Brazil, you call out $0.1 billion of impairments that you took in Brazil on the slides. I just wonder whether any of those relate to the ongoing Brazilian business that you're going to be retaining in that geography.

Iain Mackay

I'll take those in reverse order. The step-up on the Brazil impairment was mostly on the personal book, which is going. In terms of what we're retaining, large corporates, the answer is no.

In terms of the $400 million impact on RWA, where Samir came out when we were talking about this back in June was probably around a $400 million, excluding legacy. That remains a reasonably consistent view on a run-rate basis. On a total, annualised basis, what Samir was getting at was that he would expect to see $400 million come out of the run rate of Global Banking and Markets. Certainly, based on what we've been able to accomplish in the second half of the year, excluding legacy exits, that number remains reasonably consistent at this point in time. Should it change as we work through this environment, we will obviously keep you posted, but I think Samir is still confident about falling within that range.

Stuart Gulliver

You can roughly pro rata it. The amount of RWAs he has taken out, as a percentage of the total he is going to take out, which we communicated last June, you can apply across the $400 million.

Iain Mackay

On the jaws number, I have the same answer as before, David. We've got very clear programmes in place and we have good traction in getting our $4.5-5 billion out of the cost base. It's tracking very much

towards achieving that 2017 exit run rate being equivalent to our 2014 run rate. If there's a reasonably supportive revenue environment, that provides some encouragement for hitting the positive jaws number, but I think what we very much look at is the importance in continuing to invest not only in the growth capability but, also, in the regulatory compliance and global standards capability of the Firm in the longer term.

We will absolutely respond, as we have through the third and fourth quarters, to short-term pressures in terms of cutting back on things like travel & entertainment and the very short cycle expenses, which we can sink our teeth into. Structurally, which is the focus of a great many of the programmes we are focused on, it goes to the long-term efficiency and productivity of the organisation. It is a little bit too early for us, in the course of 2016, to be going back to teams and saying, 'Right, let's tee up another big slug,' because we've already got a big target in front of us the teams are focused on.

Stuart Gulliver

We are already committed to cut a little over 15% of our total cost base. It's too early. We haven't finished the second month of the year. We need to see whether this trend deepens. If it does, we will respond at the half year. But we're committed to taking out a very large chunk of our cost base, and we'll do that. We're absolutely committed to do that and, as I say, if we do need to revisit it, it is not yet.

Tom Rayner, Exane

I have a couple of questions. The first one is going back to the progressive dividend policy and then I have a second question on TLAC, because I know Iain would have been disappointed to have gone through the whole call without one.

On the progressive dividend policy, I just want to push you a little bit more on the commitment here. Obviously, capital build has slowed a little bit in the second half. We've still got potential RWA inflation and IFRS 9 to absorb. There are earnings pressures out there, not least TLAC, which maybe we'll come onto. The pay-out ratio on a statutory basis is 78%, and it could go higher if BoCom were to be de-recognised. Again, I hear what you say about the lack of any sort of cash or capital impact, but, again, it could cosmetically go higher.

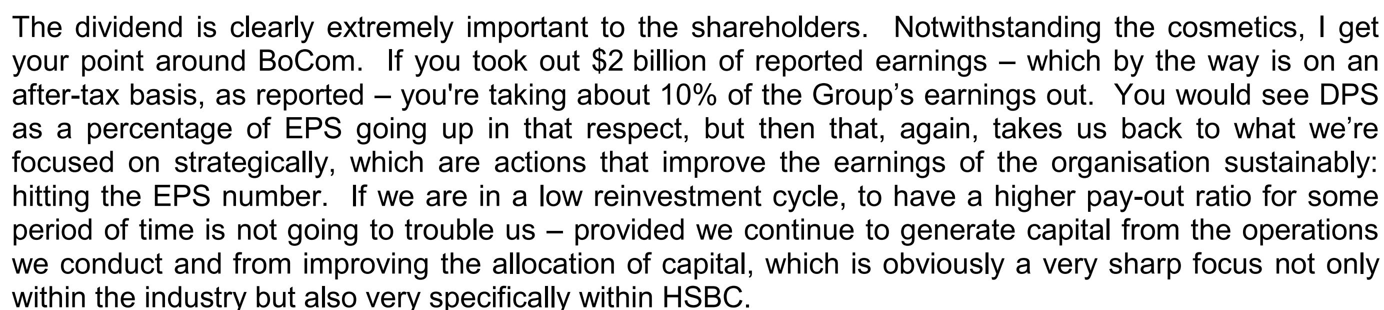
I'm just wondering: how important is the progressive dividend policy to you? You mentioned in one of your answers, I think, that if you were investing in profitable growth, maybe you would bring that pay-out ratio back down again. I just wonder whether I can test you a little bit more on your commitment there, and then I have a second one on TLAC itself, please.

Iain Mackay

I hate to disappoint, Tom, but I really don't have a great deal to add to the answer I gave your colleague about 15 minutes ago. The progressive dividend is and always has been a long-term view on the dividend-paying capability of the Firm. The last two years of our actions have demonstrated that short-term volatility in the profitability of the Firm – and as you know, the volatility of profits within this firm is fairly low anyway – has not informed our actions with respect to either keeping the dividend flat or, in actual fact, cutting the dividend – principally on the basis that we see good capital generation.

If you think about our capital position at the moment, we're sitting at 11.9% common equity tier 1 ratio on an end-point basis, which is well above where we need to be. On the closure of the Brazilian transaction, we will add some 60 basis points to our common equity tier 1 ratio. That puts us at 12.5 before we count any capital generation from the first half of the year's operations. We've set ourselves a target, which, certainly based on everything we see coming through the regulatory framework at this point, is continuing to be appropriate, to get to a common equity tier 1 ratio between 12-13%.

Continued capital generation, even at a slightly slower rate than we have been able to accomplish, whether it is in 2015 or 2014, will see us above the midway point of the 12-13% range we would expect, during the course of 2016. Where we are with dividends will absolutely be informed not only by the profits of 2016 but, also, the profits in the context of the overall capital position of the Group, as well as the outlook for profit generation and growth over the coming 12-24 month period. It is a long-term view.



The dividend is clearly extremely important to the shareholders. Notwithstanding the cosmetics, I get your point around BoCom. If you took out $2 billion of reported earnings – which by the way is on an after-tax basis, as reported – you're taking about 10% of the Group's earnings out. You would see DPS as a percentage of EPS going up in that respect, but then that, again, takes us back to what we're focused on strategically, which are actions that improve the earnings of the organisation sustainably: hitting the EPS number. If we are in a low reinvestment cycle, to have a higher pay-out ratio for some period of time is not going to trouble us – provided we continue to generate capital from the operations we conduct and from improving the allocation of capital, which is obviously a very sharp focus not only within the industry but also very specifically within HSBC.

Tom Rayner

Thank you for that. On TLAC, did I see a figure somewhere that your issuance requirement is $60-80 billion over the next two or three years? I think that was on one of your slides.

Stuart Gulliver

That's the gross number. It's $60-80 billion, but the net requirement is much smaller.

Tom Rayner

Okay, because I saw you put the redemptions number in as well, which I guess indicating that the net issuance requirement is quite small. I guess one of the things we have seen in recent weeks is quite a big widening in spreads between HoldCo debt and OpCo debt. I guess that reflects the market's concerns about bail-in. Whether that's sustained or not remains to be seen, but I think we have seen quite a big widening there for most banks. I am just wondering whether you'd give us an indication of what sort of cost implications meeting that TLAC requirement would have for HSBC. I don't know whether you can scale it any way.

Iain Mackay

At the risk of stating the obvious, right now wouldn't necessarily be our preferred time to be in the market issuing large amounts of debt. What was encouraging over the course of the last week was that we saw the spreads tightening again across three-, five-, seven- and 10-year maturities in senior debt for ourselves and, to a slightly lesser degree, in tier 2s. The AT1 market is deeply dysfunctional right now. I wouldn't have any anticipation of us trying to do any AT1 for the obvious reason that I would like to see a little bit of structural stability come into that market and people getting their heads around what those instruments actually mean from an investor's perspective. We won't go back and revisit my less-than-entirely-complimentary remarks about AT1 from two or three years ago.

From a TLAC perspective, it is senior debt, so our expectation is that probably, over the course of the next few weeks, we'll investigate going out into the market with some senior debt to meet our TLAC requirements. Broadly speaking, we still price inside or very much in line with the very best of our peer group in this category. Were we to issue today, it would obviously be a little bit more expensive than it was going back a couple of months. Again, it's kind of going to be informed by our ratings – and our ratings, again, pretty much sit at the top of the pile.

But the interesting challenge around TLAC is timing. The regulators are holding everybody's feet to the fire around the 2019 compliance date. The industry has consistently and repeatedly challenged the regulatory authorities around the world on the industry's ability to hit that mark in an orderly manner by 1 January 2019. Given some disruption in the market over the course of the last few weeks, we will no doubt continue to be in discussion with regulators, but, if we have to go at higher rates, then obviously there's going to be a slightly higher cost for us.

What I can say is that, as we build this requirement, our end state, if we end up at the top end of that range of $80 billion gross issuance, we would expect the net interest income effect on the P&L to be somewhere in the range of $800 million. That is obviously a little bit higher than earlier estimates of cost that I gave to you at the third quarter.

Manus Costello, Autonomous Research

I actually wanted to follow up on the TLAC question as well, please. I wanted to see whether you had changed your approach to resolution. When we talked about this previously, you were talking very much along the lines of MPE, but the way you talk about this now – about issuance coming out of HoldCo and downstreaming capital – seems much more SPE driven. I wondered whether that was one of the changes in approach that has led to this increase in guidance from $200-300 million of impact up to $800 million of impact. I also have a second question on GBM.

Iain Mackay

On TLAC, no, doing single point of issuance and single point of resolution are two entirely different things. Our ability to issue out of the holding company and our ability to push that down to the appropriate subsidiary such that it meets TLAC regulatory requirements are quite distinct. I think in the short-term one of the reasons that we are doing it out of the holding company as opposed to intermediate holding companies is the US – the Fed's proposal on TLAC, where their proposal – which we provided a comment letter to the Fed in the deadlines required – would require all of the debt to be issued internally. And so as a purely practical matter, as we start the issuance of these instruments in the marketplace, which again as I say is senior debt with some modifications, we're doing it out of the HoldCo until there is greater regulatory clarity around exactly how the international community wants to go with this. The FSB has said intermediate holding companies, so for us that would have been, broadly speaking, one in Europe, Asia, one in the United States. The Fed comes out and says, 'No, it's all got to be done through the parent company'. So there's a very practical reason, Manus, behind why we're doing this out of the holding company, at least as a starting point. And I think, to set a reasonable expectation, at least through 2016, any TLAC issuance will be done out of the holding company and then downstreamed. But that, in and of itself, in our view, doesn't necessarily put multiple point of entry at risk.

I think a wider question, which may challenge the multiple point of entry resolution approach, is exactly the Federal Reserve's proposals around TLAC. If everything has got to be done out of a parent company, and that is the level at which you're going to push losses back to, as opposed to recognise losses at the intermediate holding company or the operating company, then I think that may conceptually be a challenge to multiple point of entry resolution. But I think we've still got quite a lot of work to do with our regulators. As an industry. This is not unique to HSBC, but as an industry we've still got a bit of work to do in this regard.

On the quantum, the original estimates that we provided back in June were based on how it would impact the three principal subsidiaries of the Group, not the Group as a whole. When we updated you at the third quarter we provided an estimate for TLAC issuance for the Group as a whole, and that's when we provided the $60-80 billion overall issuance, and a cost in the range of $500-600 million.

Manus Costello

Got it. My second was GBM. I just wanted to ask about returns in GBM, because you seemed quite pleased with the performance of GBM. You referred to it as the star performer. But if I look across the year, client facing and BSM is doing a return on risk weighted assets of 1.8%, and a lot of that is being generated by BSM I would guess. And I think you're targeting 2.7% on that metric. I wondered, what are you going to see to drive that further, because you're more than halfway through the RWA reduction, I believe. How are you thinking about that return on risk weighted asset metric for GBM, because it doesn't to be – it seems to be a long way from target?

Iain Mackay

So we hit 2% this year on client facing business for Global Banking and Markets. You're absolutely right that the threshold for Global Banking and Markets – our target, rather, is 2.7%. The focus of RWA reduction, about – of our total of $290 billion, 275 on constant currency, about $135-140 billion of that targeted within Global Banking and Markets. That includes some of the legacy credit. And the very reason we're targeting that is that it is low returning business within the global banking and the global markets businesses. So although a great deal's been accomplished by Samir and the team in this regard in 2015, there is still a long way to go. But to be clear, the business that Samir now writes is set at the threshold that he needs to generate, and consequently that has got to work its way through the book. So you're right, Manus. There's still a lot of work to do in this business, but we are making good progress.

Chris Manners, Morgan Stanley

Good morning, everyone. I have three questions if I may. The first one was on PPI. Obviously the internal recognised cost is up to $4.7 billion now. $0.5 billion charge for 2015. Just trying to work out does that take into account Plevin and the consultation, and should we expect that to be the last from PPI? I know there's uncertainty around that, but is that your best guess, or should we be expecting more charges in future quarters? The second point is FX. Obviously dollar's strengthened quite a bit. Would it be possible just to give us an impact if the dollar stays where it is versus all of the other currencies, how much of a revenue drag that would be? Obviously the dollar's been strong this year. And the last point was just on capital. Pillar 2A was meant to come down, but it's gone up to 1.3% now. Counter-cyclical buffers have come in. Obviously you're still confident about you're 12% to 13% CET1 ratio. Just trying to work out – you're saying you're going to be at 12.5% pro forma. What happens when you get to that 12.5% and you still keep building capital because you keep making profits and running things down?

Iain Mackay

So I think I answered your last question already, Chris. If we find ourselves in the position that was capital surplus to our requirements, then I think that's going to be reflected in the pay-out that we see coming through dividends. We'll deal with that issue when we get to that point. I think our preference would be to see a good balance between obviously meeting our capital requirements, having a very constructive market environment into which we can re-invest some of the capital that we're generating from the business while continuing to pursue a progressive dividend policy for our shareholders. So I think I've probably answers your last question in that regard.

And to be clear, at this point the counter-cyclical buffer impact on HSBC is extremely muted. We've got an application of a small counter-cyclical buffer, which we do know will grow, in Hong Kong, but that is factored into our exposures for the Hong Kong business. We've got a small counter-cyclical buffer applying to our Scandinavian exposures, of which we have very, very little, but that's factored into our capital numbers at this point in time. And the Pillar 2A is very much where we expect Pillar 2A to be at this point. I think as we work through 2016 with the PRA we'll submit our internal capital adequacy assessment process at the end of the first quarter. Our regulators will sit down and look at that from a strength standpoint, and probably sometime during the second half come back to us with whatever their assessment is of Pillar 2A, and we would expect some indication then about what the PRA buffer may hold for us as well. So we'll learn more about that in the second half of the year. Going to PPI we have factored in – yeah, sorry?

Chris Manners

What I was going to say is because if you have a progressive dividend policy, and you find that you have a little bit more capital than you need, and not that many opportunities to grow, you don't want to grow your dividend, because then you get stuck with that higher level. But say the capital ratio gets above 13, and 13's your ceiling, you don't want to increase the dividend because then you're forced to keep that progressive, but you just end up with a little bit too much capital. How would you think about managing that outcome?

Iain Mackay

Well, there are other aspects we could certainly consider. It would depend on what our capital position was attributable to. So we have in the past talked about doing buy backs. I think if we were to launch buy back probably we would want to launch something we could reasonably sustain. Again, that's a fine judgement. It's a little bit in the margins of where we would find ourselves, Chris. But, frankly, if I find myself in that position I'd find it a fairly high quality problem to be dealing with.

From a PPI perspective, we certainly have considered impact of the FCA consultation in terms of trying to bring this issue to a close by the spring of 2018, and we've included our consideration of the impact of Plevin in the same provision. So as you probably observed, over the preceding several quarters our provisions for PPI have started to diminish quite considerably. So in the fourth quarter we took an informed view, certainly based on our own operational data, of how this could be brought to resolution in April 2018, or spring 2018 as it relates to both PPI and possible implication of Plevin, and have made provision accordingly. If the FCA guidance is in line with the consultation, then we'd like to think we won't

have much more in the way of significant provisions for PPI, but we obviously need to get the final outcome of the FCA consolation and we'll take it from there.

On FX, I'm just trying to figure out how to give you the FX impact on my revenues for 2016 without telling you my budgeted number for 2016 revenues.

Stuart Gulliver

Or guess at what the foreign currency translation will be.

Iain Mackay

Or a guess. But what I can tell you, which I'm sure won't necessarily satisfy you enormously, but if I give you the impact on our 2015 revenues of foreign exchange, the impact on revenue of FX was -$4.8 billion.

Chris Manners

So that's how much 15 declined versus 14?

Iain Mackay

That was 15 versus 14.

Stuart Gulliver

Correct. 4.775, to be precise.

Chris Manners

How do we think about carrying that forward, because presumably there'll be still a headwind?

Iain Mackay

The only way I give you that number is give you my budgeted revenues, and I'm sorry to tell you but I'm not going to do that.

Chris Manners

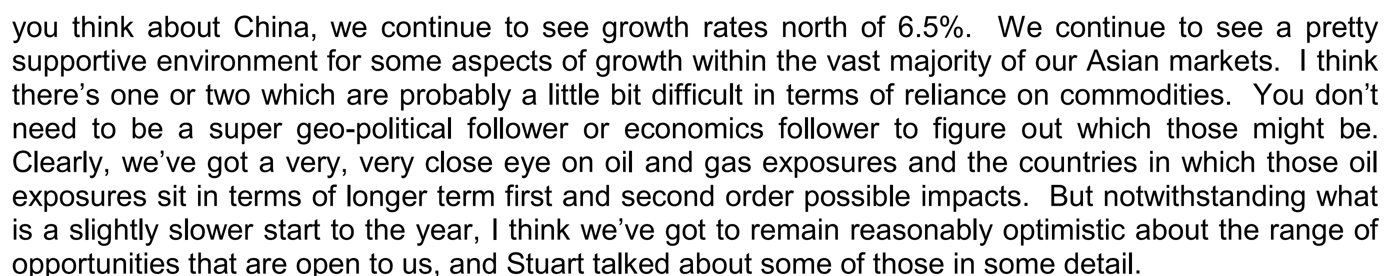
No problem.

Michael Helsby, Bank of America

Thank you. I've just got two questions, if I may. First, just on the shape of the yield curve, I think at the time of your strategic review you commented that you'd allowed for the then shape of the curve within your 2017 revenue outlook to get to your ROE. It feels like there's been a big flattening of the curve since then, so I was wondering if you'd done the math that if you marked it to market today what would that do to your revenue expectation that you set out – embedded at the strategy day? That's question one. And just on question two, thanks for your comments on the dividends, Iain. The focus has been on dividend increases, but given your stock's yielding well over 8% on the dividends that you've released today it does feel like the market's worrying that you're going to cut your dividend, not grow it. So probably a better question to ask, given where your share price is, is what scenario you need to see for you to be recommending a dividend cut, not keeping it flat or growing it? Thank you.

Iain Mackay

I guess on the last scenario would be a scenario that nobody on this telephone call would particularly look forward to seeing. So when was the last time that the Group cut the dividend? That was 2009, and that was in conjunction with a rights issue on the back of what was a clearly well-developed financial crisis, and certainly something idiosyncratic to HSBC where significant losses coming through a sub-prime portfolio in the United States. To put that in context, our United States sub-prime exposure at the end of 2007 was $160 billion-plus. We have no other single exposure in the Group that is even close to that in 2015. None. Now, is it an interesting economic environment which we're operating in? Absolutely. But I think, at the moment, all of you, and a great many other commentators are trying to figure out the fundamental economics against some of the market volatility that we're seeing today. So if



you think about China, we continue to see growth rates north of 6.5%. We continue to see a pretty supportive environment for some aspects of growth within the vast majority of our Asian markets. I think there's one or two which are probably a little bit difficult in terms of reliance on commodities. You don't need to be a super geo-political follower or economics follower to figure out which those might be. Clearly, we've got a very, very close eye on oil and gas exposures and the countries in which those oil exposures sit in terms of longer term first and second order possible impacts. But notwithstanding what is a slightly slower start to the year, I think we've got to remain reasonably optimistic about the range of opportunities that are open to us, and Stuart talked about some of those in some detail.

Again, we take a long-term view of dividends, and one of the key inputs to dividends is the profitability that we generate in a year. We cannot – you can't live in isolation off the capital base. You've got to continue to generate capital from the profits. And a great many – in fact the majority of the strategic actions that we laid out last June, and that we are focused on and delivering against, are about improving the profitability of the Group and creating opportunities for growth at the revenue base to support that profitability.

On the interest rate impact, that's an interesting way of asking the same question as Chris did, so well done. What I can say is what we looked at in terms of planning from an interest income perspective is that we pushed the curve that we were looking at as we were doing our plans in the third and fourth quarter out 12 months.

Michael Helsby

Right.

Iain Mackay

So put that in the baldest possible terms, we did not factor in significant US dollar or sterling rate increases in 2016.

Michael Helsby

Okay, so you would have had about $1 billion or so of positive benefit that probably has disappeared?

Iain Mackay

Our expectation on rate increases is somewhat bearish.

Michael Helsby

Okay, thank you.

Iain Mackay

But that has been the case now for five years.

Stuart Gulliver

Thank you very much, that brings the call to an end.