Edited Transcript

1Q 2016 Earnings Release

Conference Call with Investors and Analysts

03 May 2016

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

Forward-looking statements
This presentation and subsequent discussion may contain certain forward looking statements with respect to the financial condition, results of operations and business of the Group. These forward-looking statements represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Additional detailed information concerning important factors that could cause actual results to differ materially is available in the HSBC Holdings plc 1Q 2016 Earnings Release and Annual Report and Accounts 2015. Past performance cannot be relied on as a guide to future performance.

HSBC

Stuart Gulliver, Group Chief Executive

Good afternoon from Hong Kong. Good morning to everyone in London and welcome to our first quarter results call. With me today is Iain, who is going to take a look through the detailed financial performance. We will then both then take questions, but I'll start by pulling out a few highlights.

Our first-quarter performance was resilient in market conditions that challenged the entire banking industry. Against a very strong first quarter of 2015 profits were down, although we increased market share in many of the product areas that are critical to our strategy. Market uncertainty led to extreme levels of volatility in January and February, which affected our ability to generate revenue in our markets and wealth management businesses. Both businesses recovered well in March.

Our diversified universal banking business model helped to cushion the impact through growth in other parts of the Bank. Commercial Banking (CMB) continued its momentum in spite of the slowdown in global trade, and we increased market share across our strategic trade corridors. We also grew revenue elsewhere in Retail Banking and Wealth Management (RBWM), particularly current accounts and savings in Hong Kong and the UK, and personal lending in Asia and Mexico.

A combination of tight cost management and the increasing impact of our cost-savings programme has reduced operating expenses compared to the fourth quarter. We kept them broadly unchanged compared to the first quarter of 2015. Loan impairment charges (LICs) were down by $450 million compared to the fourth quarter and up by $692 million compared to the first quarter of 2015.

We maintained a strong Common Equity Tier 1 (CET 1) ratio of 11.9%, adding $800 million to capital, net of dividends. We also maintained a strong leverage ratio of 5%. In March, we sold $10.5 billion equivalent of Total Loss Absorbing Capacity (TLAC) securities in US dollars and euros across five separate tranches in a range of maturities in both fixed and floating format. Our order books were well oversubscribed in spite of market volatility and difficult new issue conditions and we had demand from an extremely broad range of investors. This was the largest senior unsecured fund-raising by a bank since 2008. It re-opened the benchmark wholesale-funding markets for UK and European bank holding companies.

Our targeted initiatives removed another $15 billion of risk-weighted assets (RWAs) in the first quarter. Risk-weighted assets increased overall due to an increase in corporate lending. Higher market volatility and some corporate credit downgrades also increased risk-weighted assets. We remain on track to hit our risk-weighted assets reduction target.

The technical body of the Brazilian Competition Agency has now recommended to its board that the sale of our Brazil business be approved. We await a final decision from the Competition Agency. This is the final regulatory approval required prior to the completion of the transaction. Completing the transaction will add approximately 60 basis points to our CET 1 ratio.

Our Asian businesses continue to gain momentum. We made important market-share gains in debt Capital Markets, China Mergers & Acquisitions (M&A) and syndicated lending. We also had strong business wins on the back of our increased investment in Asia and we extended our leadership in services related to renminbi internationalisation.

Iain's now going to take you through the numbers.

Iain Mackay, Group Finance Director

Looking at some key metrics for the first quarter on slide 3, the reported return on an average ordinary shareholder's equity was 9%. The reported return on average tangible equity was 10.3%. On an adjusted basis, we had negative jaws of 2.8%. The movement in jaws was mainly due to a 3.8% decline in adjusted revenue, which exceeded a 1% fall in adjusted costs.

Slide 4 takes us from reported to adjusted. Reported profit before tax of $6.1 billion for the first quarter included a $1.2 billion gain from fair value on our own debt, relating to credit spread, and $479 million of other significant items. Allowing for these items leaves an adjusted profit before tax of $5.4 billion for the

first quarter. You'll find more details on these adjustments in the appendix and we'll focus on adjusted numbers for the remainder of this presentation.

Slide 5 shows the comparison with the fourth quarter of 2015. Adjusted profit before tax was $3.6 billion higher than the fourth quarter due to higher revenue and lower loan impairment charges and costs. You'll recall that the Bank Levy influences the fourth-quarter numbers. Excluding the Bank Levy, operating expenses fell by $236 million. Loan impairment charges were $450 million lower, mainly in Commercial Banking. The fourth quarter included an increase in specific loan impairment charges in a small number of countries, which largely reflected local factors and collective charges relating to oil and gas.

Slide 6 breaks down adjusted profit by global business and geography on a period-by-period basis. These profits were achieved in challenging market conditions and relative to a very strong first quarter last year. The main business drivers of the reduction in profit were lower revenue in Global Banking and Markets, and Retail Banking and Wealth Management, and increased loan impairment charges in Global Banking and Markets, principally related to oil and gas and metals and mining. We've split out Brazil from the rest of the Group here to show the impact it had on our numbers in the first quarter. This also gives you a basis for comparison for when Brazil drops out of our numbers following completion of the transaction. We expect this to have a positive impact on operating expenses, loan impairment charges and capital.

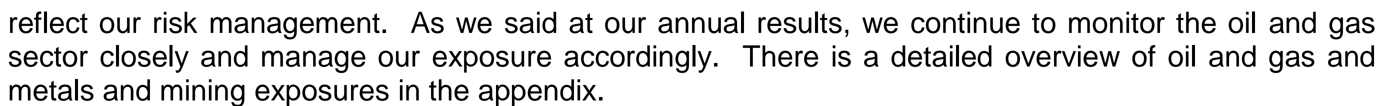
Slide 7 shows an analysis of revenue. As Stuart said earlier, conditions in the first two months of the year were difficult, particularly in our Markets businesses and Wealth Management. There was a clear improvement in March, however, and that continued into April. You'll recall that our performance in the first quarter of 2015 included the positive impact of the Shanghai-Hong Kong Stock Connect and the strong renminbi market, which benefited us more than most. It's worth noting that our revenues are down no more than the industry average in spite of this.

In Principal Retail Banking and Wealth Management, revenue was $270 million, 5% lower than the first quarter of 2015. This was mainly in Wealth Management, caused by the impact of adverse movements in interest rates on equity markets and life insurance, as well as lower customer activity. We did, however, grow revenue from customer accounts in Hong Kong and the UK and from higher personal lending in Latin America and Asia.

Commercial Banking revenue continued to grow, driven by higher average balances in Payments and Cash Management and further loan growth. Client-facing Global Banking and Markets revenue was down by $286 million, or 7%, compared to a strong performance in the prior year. In common with the rest of the Banking industry, extreme levels of market volatility led to reduced client activity in our Markets business, particularly in Equities, Credit and Foreign Exchange. Revenue was up in Rates. There was $172 million reduction in revenue from Balance Sheet Management (BSM), due in large part to lower gains on disposal of available-for-sale securities.

Global Private Banking (GPB) revenue was down by $87 million or 15%, due to lower brokerage and trading activity in Europe and Asia. However, we attracted $4 billion of net new money in the quarter. Other provided $179 million of revenue in the first quarter. This included favourable fair-value movements associated with long-term debt issued by HSBC Holdings. These are related to interest and exchange rate risk, but not our own credit spread, which we excluded from adjusted performance. In last year's first quarter, 'Other' had losses of $200 million mainly from the adverse impact of several intra-group adjustments. This means that revenue for 'Other' was up by $379 million on a quarter-by-quarter basis.

Loan impairment charges were $692 million higher than the first quarter of 2015, but $450 million lower than the fourth quarter. $159 million of the increase on the first quarter of 2015 came specifically from Brazil, due to difficult economic and trading conditions. These were mostly collectively-assessed impairments in Retail Banking and Wealth Management. The increase also includes an adjustment of around $100 million in our US run-off portfolio. Charges in wholesale were up by $380 million. Q1 included additional specific charges related to oil and gas, mainly in the US and Canada. There was also a charge in Australia related to metals and mining, as well as higher specific charges in a small number of countries. As the chart shows, the level of loans reported as past due but not impaired continues to



reflect our risk management. As we said at our annual results, we continue to monitor the oil and gas sector closely and manage our exposure accordingly. There is a detailed overview of oil and gas and metals and mining exposures in the appendix.

Adjusted operating expenses were $76 million or 1% lower than the first quarter of 2015. Excluding Bank Levy adjustments in each period, we were successful in keeping costs broadly unchanged in spite of the effect of inflation and $743 million of investment in regulatory programmes and compliance. This investment reflected the continued implementation of our Global Standards programme and other requirements. As we said in June, we expect this investment to continue throughout 2016 and to flatten in 2017 as increased automation and process improvements take effect. You'll recall that our cost-savings programme is designed to cover the cost of investment in Global Standards, investment in growth and the impact of inflation, as well as to achieve an exit rate equivalent to 2014 by the end of 2017.

In Commercial Banking, our cost-reduction initiatives neutralised the effect of both inflation and increased investment in Global Standards. These included our simplified organisational structure and process optimisation in our lending, on-boarding and servicing platforms. Costs were down marginally in Retail Banking and Wealth Management as investments in our branch network and inflationary pressures were more than offset by cost savings, including our Digital Transformation and branch-optimisation programmes. Costs fell in Global Banking and Markets, due primarily to lower staff performance costs in Asia, Europe and the United States. This continues the good start that we made to our cost-saving programme. We remain confident of hitting our cost target. Re-based for currency translation and the sale of Brazil, that target is now $29.1 billion.

Turning to capital, the Group's Common Equity Tier 1 ratio has maintained at 11.9%. We increased common equity tier 1 capital by $2 billion in the first quarter. This was from capital generation through profits net of dividends of around $800 million, and we benefited from favourable foreign currency translation differences of $1 billion. While total RWAs increased in the first quarter, we continued to make progress with our risk-weighted assets initiatives. The next slide sets out the movements in more detail.

The increase in risk-weighted assets in the first quarter was as a result of book size and quality. Growth in book size was mainly driven by two things: increased corporate lending, mainly in Commercial Banking and Global Banking and Markets; and increased market volatility and client activity impacting Counterparty Credit Risk (CCR) and Market Risk. Each of these accounted for around half of the movement in book size.

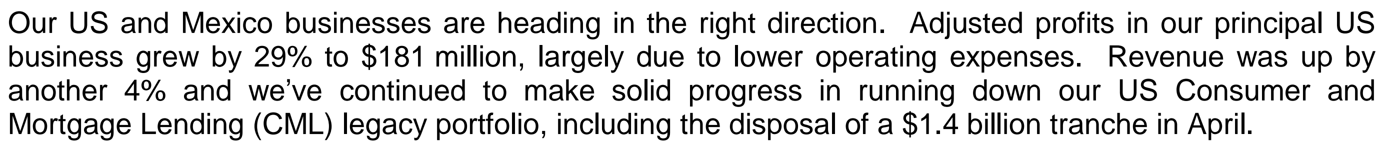
Book quality represents risk-weighted asset movements related to changes in the underlying credit quality of our customers. These movements were partially offset by our continued progress on RWA initiatives. At our Investor Update in 2015, we set a target to reduce the Group's risk-weighted assets by $290 billion by the end of 2017. The chart at the top right of the page shows this target adjusted for the latest foreign-exchange rates. This gives a rebased target of $279 billion.

Since the start of 2015, we have reduced risk-weighted assets by $139 billion, of which $15 billion was in the first quarter of this year. These reductions include legacy credit and US run-off portfolios. Our risk-weighted asset reduction plans are on-track and we remain confident of hitting our targets by the end of 2017.

The reported return on risk-weighted assets was 2.2%, compared to 2.4% in the first quarter of 2015. We continue to work towards an adjusted return on risk-weighted assets of greater than 2.3% by 2017.

Stuart Gulliver

Slide 13 provides a summary of our progress in the 11 months since our Investor Update. Iain's already talked about risk-weighted assets and I've already talked about Brazil, so I'm going to concentrate on the other actions here.



Our US and Mexico businesses are heading in the right direction. Adjusted profits in our principal US business grew by 29% to $181 million, largely due to lower operating expenses. Revenue was up by another 4% and we've continued to make solid progress in running down our US Consumer and Mortgage Lending (CML) legacy portfolio, including the disposal of a $1.4 billion tranche in April.

In Mexico, adjusted profit before tax was $72 million, up 104% on the first quarter of 2015. This was due to higher lending balances in Retail Banking and Wealth Management, higher insurance revenues and improved collaboration between Retail Banking and Wealth Management and Commercial Banking. We're also getting good traction in terms of cross-border businesses in the area covered by NAFTA. We have double-digit growth in Commercial Banking across the free-trade zone and we're currently winning three out of four cross-border deals in the region.

As Iain has already said, we've made good progress on operating expenses while continuing to invest in growth initiatives and regulatory programmes and compliance. All of our cost programmes are now underway. We've reduced employee numbers by around 6,000 since the first quarter of last year and the sale of Brazil will reduce FTEs by a further 19,000 to bring the Group total to 235,000. This compares with 295,000 on 31 December 2010. As this trend illustrates, we've got a good grip on cost. Although progress will not be linear, we're confident of hitting our target by the end of 2017.

Our Payments and Cash Management business maintains its strong momentum, with an increase of 7% on the first quarter of last year. Global Trade and Receivables Finance maintained its position in a slow trade environment and captured additional market share across our top 23 strategic corridors.

In the first quarter, we also received clearance to offer our own credit cards in mainland China. Adjusted profit before tax was at $357 million in ASEAN, which was up 14% due to lower loan impairment charges and lower costs. We've also increased assets under management in Asia by 10% in the first quarter and grew revenue from insurance manufacturing new business premiums in Asia by 18% to around $600 million. Revenue from renminbi internationalisation was down, but we have strengthened our leadership position in the quarter. I'll talk more about this on the next slide.

Slide 14 shows the numbers behind the story. We've increased our market shares across a number of product lines as we have invested in the business and competitors have withdrawn from some of our core markets. In the first quarter, we held our share of the market in Global Trade and Receivables Finance, but increased our market share in four out of five regions in documentary trade. We also strengthened our leadership position in Payments and Cash Management. We are a market leader in Asia for advisory business and we have strengthened that position considerably. We're the established number-one underwriter in Debt Capital Markets and we've retained our number one ranking for Syndicated Loans in Hong Kong and mainland China, and further increased our market share there. We've also dramatically increased our share of the Asian Mergers & Acquisitions market.

Finally, we have retained our number one position in the league tables for offshore renimbi bonds and have a 52 per cent share of the Securities Services RQFII market. This puts us in an excellent position not just to benefit from a more stable renimbi market, but from the relaxation of investment barriers for onshore bonds, and the likely roll-out of the Shenzhen-Hong Kong Stock Connect later this year. No other bank is in as strong a position to capitalise on these opportunities.

In summary, we've shown resilience and made further progress towards the completion of our strategic actions. We intend to keep reporting on this progress on a quarterly basis. The market volatility that affected the first two months of the year has largely stabilised. March was a better month than both January and February, and April has continued in broadly the same vein. Despite the difficult conditions, our diversified and balanced business has enabled us to continue to generate growth and to capture market share where possible.

There continue to be plenty of revenue opportunities available to us in the coming quarters, particularly in the areas we're targeting for growth. The planned Shenzhen-Hong Kong Stock Connect and the opening up of the China interbank bond market will enable us to capitalise on our market access in Asia. The increase in Chinese Outbound Direct Investment (ODI) and M&A involving Chinese firms plays to our leadership of the Asian advisory market. The roll-out of the 'One Belt and, One Road' initiative and the growth of green finance will create opportunities in infrastructure finance and green bonds, both of which

are already significant areas of strength for HSBC. We're confident of achieving our target of $4.5-5 billion of cost savings by the end of 2017. Our strong balance sheet gives us the latitude to manage the business for the long term, in accordance with our strategy.

We will now take questions.

Alastair Ryan, Bank of America

On net-interest margin (NIM), it sounds like its stabilising underlying in the quarter, but down a bit on a reported basis, ex Brazil. Now the Fed has started hiking rates, if only a little, can you give me a sense of whether you've hit the bottom on the margin? It's been a long down-draft, as rates hit zero.

On trade you sound a bit more downbeat in the text but a bit more positive on this call. Could you give us a sense of where you think your trade revenues are headed across volumes and margins, please?

Iain Mackay

On net-interest margin it's very, very stable compared to the fourth quarter of last year. I think that can be true across all of the main product lines with respect to net interest margins. Going forward, one of the things that will create a little bit of pressure on NIM at a Group level is the cost of TLAC.

We talked about that at the end of the year and going forward, but when you look at it on a trading basis the net-interest margin has been very stable in the fourth quarter. Certainly, there were no indications of particular pressure coming through beyond some of the factors we talked about a few weeks ago when we released the full-year numbers – so it's very consistent.

Stuart Gulliver

Going on trade, the overall macro backdrop, as you know, is that trade growth was very sluggish, at about 2.8% growth last year in 2015 and actually quite a sharp decline in the value of trade, by about 13%. Those are overall World Trade Organisation (WTO) numbers. What we've seen within our business is growth in trade within Global Banking and Markets, where revenue is up about 3%, and decline in Commercial Banking business, where revenue is down about 6%. But, if you dig into it, there's a decline in documentary trade balances, which are down about 13%. However, Structured Trade and Receivables Finance is up about 15%. Now, actually, that is positive for margins in the longer-term because documentary credit has been extremely competitive with very, very tight margins. As the market moves towards Structured Trade and Receivables Finance, that actually should offer some revenue growth.

As it stands, we've grown market share. February 2016 data from the Hong Kong Monetary Authority suggests that the overall market for trade balances is down about 34% in Hong Kong. We're down about 9% in Hong Kong, which indicates we've taken market share. To be honest, we're slightly more positive than, perhaps, the text suggests, but it's a complicated picture. What we can see is that we're outperforming the overall market across our 23 strategic trade corridors, and our declines are considerably less than the market is showing – and there's a switch from documentary credit to structured trade, which itself has better margins.

Raul Sinha, JP Morgan

On revenues, page 20 of your release, where you talk about Principal RBWM, I particularly wanted to focus on wealth products, where you obviously had $1.2 billion off top line this quarter. That was one of the areas that was impacted by the volatility, but if you look at the comps against last year, last year for example you had $1.9 billion of revenues in this business in the second quarter, presumably helped by China's bull market. I was just wondering if you could talk a little bit about the outlook for this business. How would you characterise your performance in the first quarter here and how should we expect this to move going forward?

Iain Mackay

One of the things to bear in mind about the first quarter of last year was the incredibly strong performance coming through on the back of the Shanghai-Hong Kong Stock Connect, which represented

a significant uplift to revenues coming through Retail Banking and Wealth Management in the Asian market, specifically Wealth Management.

The other feature that had, again, a somewhat positive effect on overall present value in force (PVIF) coming through was, in the first quarter of last year, we saw almost the exact opposite in the first quarter of 2016. When you look at the overall impact on Retail Banking and Wealth Management revenues, that's really what it boils down to: market updates coming through PVIF and the insurance manufacturing businesses – that is mostly within Hong Kong and France – and then the impact of lower brokerage revenues.

If you look at the performance coming through, if you like, the installed base of current accounts, mortgages, unsecured personal lending, the overall outlook remains fairly stable across each of the major markets for us. The UK has been reasonably positive for us in the first quarter. For fairly obvious reasons, Hong Kong has been a little bit slower, but the main drivers of revenues have been the two features and the comparison with the first quarter of last year.

Stuart Gulliver

It's worth bearing in mind that it's a combination of Retail Banking and Wealth Management, as the name suggests. The Wealth Management piece, as Iain's just outlined, is kind of weak because we had such a strong first and second quarter last year, but, actually, we've got good growth in current accounts and savings, and in personal lending. If you look at the Retail Banking piece – i.e. current accounts, savings and deposits – if you're on page 20 (Earnings Release – 1Q16) you can see growth, and you can also see growth in the personal-lending piece.

Actually, it's not just a Wealth Management business. It's both the Retail Banking – i.e. deposits and loans – as well as the Wealth Management piece.

Raul Sinha

On that, leading into jaws and your outlook for positive jaws this year, obviously costs are down 2% ex investment and regulatory spend and the levy credit. Revenue is down 4% underlying. I guess you probably want to narrow and turn that around as the year progresses, but I suspect you will probably need a little bit of help from the revenue environment – or is there something that I'm missing in terms of cost where we should expect the cost momentum to build as we work through the year?

Iain Mackay

I think a little bit of help on the revenue line would certainly be appreciated. The focus on the costs is to hit the $4.5-5 billion cost take-out by the end of 2017, such that we get that 2014 run-rate. There's good traction around that. We've got all the programmes up and running. The focus is very much on making sure that we can stay on top of and execute the things we control. That being said, within the revenue space a little bit of revenue would be appreciated, but, again, if you look at the underlying development of Commercial Banking, it was reasonably encouraging, when you consider the underlying trading conditions.

Overall, looking at Client-facing Global Banking and Markets, excluding Balance Sheet Management, it's down 7%, which I think is a bit of a standout on an industry-comparison perspective. We clearly saw some of the stabilisation coming though in our March revenues, and that has been broadly sustained through April. Then in Retail Banking and Wealth Management there is a very strong focus from John and the team in terms of, firstly, executing against the $4.5-5 billion in terms of managing the overall cost-equation and, also, obviously, a focus on continuing to build the customer relationships that support revenue.

We are not necessarily depending on a significant up-rate in rates, but, clearly, a slightly more stable and less volatile environment coming out of the first quarter and into the second would be helpful.

Chirantan Barua, Sanford C. Bernstein

I just have a quick one on Hong Kong. I've been following this for a long time. This is the first quarter for ages that's seen Hong Kong loan growth down across Retail, Commercial, Global Markets and Private

Banking sequentially. It'd be great to get some colour on what's happening. Stuart, your comments on trade were very helpful. The same on the retail and commercial sides in terms of growth and what the dependencies are, not only in this quarter but going forward, would be much appreciated.

Iain Mackay

I think there's probably not a great deal we can add, Chira, on top of what we've answered for the last couple of questions here. Certainly within the Retail Banking and Wealth Management space in Hong Kong, I think we saw a growth in current accounts. What I'm suspecting is that's a function of many of our customers sitting on the sidelines and waiting to see a slightly more stable environment for investing, which certainly should help support the Wealth Management revenue equation going forward in slightly more stable markets. That's certainly an expectation.

We'd like to see that overall Commercial Banking continues to perform reasonably well. Global Banking and Markets in Asia was afflicted with the same sort of underlying trends we saw coming through our European and US business. Improvements that we've seen coming though in March and April in that regard are, again, somewhat encouraging. It goes without saying that Peter and the team in Asia continue to be very closely focused on the overall cost-management picture. Also, we do have a very robust 39% cost-efficiency ratio within the Hong Kong market.

I think the other thing that's worth mentioning is that within our ASEAN market we've seen improvement in profit before tax over the course of the first quarter with lower loan impairment charges and good cost control across the businesses, with a reasonably constructive revenue environment. Notwithstanding the fact that Hong Kong is hugely important, there is more than just one arrow in the quiver on this front.

David Lock, Deutsche Bank

On rates, it looks like you had a very strong performance in the quarter, about 20% up. I just wondered whether, in the context of your commentary about the first two months of the year being a bit weaker and the third month being a bit better, and with that continuing, could you give a little bit of colour about Rates performance? Should we expect that to be sustained into the second quarter?

On costs to achieve, I think so far you've taken about $1.3 billion since the beginning of 2015. That's probably a little bit of the $4-4.5 billion off the run rate. I just wondered whether you could update us on the phasing of that and when we might expect that to flow through?

On GBM and Balance Sheet Management, in the past you have given us a little guidance on how we should expect that to roll over the course of the year. I just wondered whether you had any views at the first quarter and what we might expect for BSM this year?

Stuart Gulliver

On Balance Sheet Management, about $2.5 billion. Rates – no, I don't think you can extrapolate that forward. What I think you can look at is a recovery in Foreign Exchange, Credit and Equities. Remember, total client-facing Global Banking and Markets revenues are only down 7%, which actually, as Iain was saying earlier, compared to most of the industry was a very strong performance. Our GBM businesses – we've been saying repeatedly for a very long time – have a kind of different mixture. If you add in Balance Sheet Management, the overall adjusted revenues for the business are down 12%. I don't think you should be assuming a continued outperformance from Rates, but more that in March and April, more normalised trading conditions returned, so helping the Foreign Exchange and Equity piece more.

Iain Mackay

On costs to achieve, David, I wouldn't necessarily expect an absolute linearity in terms of the costs to achieve, just as we've talked about hopefully not anticipating exact linearity coming through in the actual costs being realised. What I would say is that normally, on the basis that we're going to recognise our $4.5-5 billion of saves by the end of 2017, you can expect the costs to achieve to come through slightly ahead in terms of the actual cost savings. We're just over $1.2 billion since inception through to the current point, and there is – I think Stuart mentioned in his comments, all of the programmes and projects

that we've got focused on realising cost saves are up and running now, as a consequence of which we'll continue to see the costs to achieve coming through over the course of the coming quarters.

Tom Rayner, Exane

Hong Kong accounted for about 38% of group profit in the first quarter. The loan book looks like it's contracted annualised 13% in Q1, Commercial itself down 20% on an annualised run rate, so either something's happened in the first quarter to explain that, or it looks like a big retrenching in terms of your appetite to lend. I noticed the loan to deposit ratio has fallen from 56% a year ago to about 48% now, so I just wondered if I could push you a bit more for some comments on what's happening in Hong Kong specifically.

Iain Mackay

On Hong Kong, we had a number of large corporate repayments in the first quarter of the year. I think the other thing that would have characterised the first quarter was relatively low demand for credit, and again, that kind of goes to some of the things we've already talked about with respect to Retail Bank Wealth Management, as well as Global Banking and Markets. But the main feature that we saw in terms of really impacting balance sheet was a little bit of corporate repayment coming through the first quarter, and lower demand. It certainly wasn't specifically as a consequence of a reduction in risk appetite from the Asian business' perspective. We also saw flat mortgage balance, as you've seen coming through; a lot of the media coverage has an expectation of declining property prices within the Hong Kong environment, and again, just a little bit of risk aversion with respect to our customers waiting to see if the environment settles down is probably the best way to characterise that at the moment.

Stuart Gulliver

And another thing that you'd have had in the first and second quarter of 2015, which was related to Shanghai-Hong Kong Stock Connect, is actually quite a lot of margin lending against equities, which clearly wasn't repeated in the first quarter of this year, which also would explain a chunk of the reduction in loans and advances.

Tom Rayner

When you sort of strip through all of that – I mean, are you looking at a reasonably stable loan book, do you think, or small contraction and small growth? What's your sort of gut feel for the true underlying sort of business that is –

Stuart Gulliver

I think flat, to be honest.

Tom Rayner

On slide 11, I just wondered if you had a bit more colour to some of the big moving parts in reconciling the RWA movements? I know there's some explanation in the text. The increase due to book size, given, again, little real growth in the loan book looks quite large, and then there's possibly the corporate downgrades driving the quality. Is there anything else you can add to what's going on, to give us a feel for what we should be thinking about for the rest of the year on some of those drivers, please?

Iain Mackay

In terms of book values, Tom, about 50% of that came from actually growing lending, and that's made up across the US, in the UK, and in Mexico, were the main drivers in terms of growth coming through from a book size perspective. And then what you also had is obviously a step up in Market Risk, risk-weighted assets coming through, some of the volatility that we saw in the first quarter reflected in the Value at Risk (VaR) and the stress VaR, and then counterparty credit risk (CCR). That's really what we saw going on, so that 16 billion book size, about 50/50 was split between actual growth in credit and lending to customers and then market volatility effects, coming through principally Market Risk and Counterparty credit risk. And then book quality was really a reflection of the downgrades that we saw happening

across both the oil and gas sector and the metals and mining sector principally, which, again, when you look at the external factors, you would certainly have expected to see that coming through.

Tom Rayner

So is it fair to say, then, if I'm thinking about going forward, the $9 billion of book quality won't necessarily repeat, and half of that increase in book size is volatility which might reverse, might get worse, but it's not something which you should expect quarter in, quarter out?

Iain Mackay

No. The aspect of market volatility is going to be driven by exactly that, but there's not necessarily an expectation of repetition around that. I think one of the other things that you need to bear in mind when you're looking at the balance sheet, is that in the first quarter, we transferred almost $6 billion out of loans and advances to customers to held for sale, and that came out of Global Banking and Markets and out of our run-off CML portfolio, the majority of that, the vast majority – 80% of it – coming out of the CML portfolio in the US.

Rohith Chandra-Rajan, Barclays

On costs: obviously, good performance there, helping to offset some of the revenue pressures. Just wondering, on the sort of $7.5 billion underlying cost, how feasible that is to hold that relatively flat throughout the rest of the year? Obviously, you've got the Bank Levy in the fourth quarter, but at the moment you're being able to offset the regulatory spend and inflation through ongoing cost reductions, so just to comment on how you see that progressing through the year. And then just on the RWAs side of things, you highlight that you're half-way through the reduction plan. Could you just give us some insight as to what you expect for the rest of the year, and then secondly also on timing of Brazil? It sounds like you're now quite close to that being finalised. Is the middle of the year realistic, and can you remind us on the RWA reduction there, please?

Iain Mackay

On Brazil, our expectation is that it'll close in the first half of the year, so by the time we speak to you next, hopefully we will have that transaction closed and the benefits coming through both the P&L and capital, and that's really one of the reasons that we provided a little bit more insight on the impact on the Brazilian numbers in the overall group, so that you can track it to each of the four quarters this year. In terms of the RWAs reduction it was $37 billion coming through the risk-weighted assets on the disposal of Brazil, and then in terms of impact on capital overall, it was about 60 basis points.

In terms of progress on RWAs for the remainder of the year, I can probably sum it up in one word: progress. $15 billion in the first quarter; obviously we've made good progress, as Stuart mentioned, in terms of getting more out of the CML portfolio in the month of April, and as I just mentioned, we've transferred a substantial additional balance to held for sale out of the CML book, and that continues apace. The US team's done a great job there, and we'll continue to make progress with the Global Banking and Markets business, both in terms of legacy portfolio as well as just continued improved management of the capital efficiency across the various models that we've got and the customer base that we've got in RWAs. But, as I mentioned, it's not something that we're planning from a linear perspective.

Stuart Gulliver

It's not linear, but if you just look at some stats, Global Banking and Markets has achieved 60% of its target already, so $84 billion out of $141 billion target. CMB, 85% of its target has been achieved, so $25.4 billion out of $30 billion, and the US CML is 43% of its 2015-17 target achieved. So, as Iain says, this is not going to be equal parts month by month, but this is a huge focus.

Iain Mackay

And on the costs, we do not actually expect to keep costs flat over the remainder of the year. I think, clearly, what you saw in the first quarter in terms of Global Banking and Markets – our costs are managed there, certainly in line with overall revenues when it comes to the performance costs for our

employees. If the revenue doesn't come through, then the accrual for bonus doesn't come through with it. But broadly speaking, as we talked about back in June of last year – and again today – we continue to invest significantly in Global Standards and wider regulatory programmes. There's an investment cycle which we provided a little bit more detail about back last June, and we expect that investment cycle to continue through 2016, and really only start to realise significant benefits in terms of lower costs in that particular space as we work through 2017. So though there's great progress made in the first quarter of 2016, we do have some programmes that we need to continue through the remainder of '16, and that will put some upward pressure on the overall cost base for the remainder of this year.

Rohith Chandra-Rajan

The regulatory programme and compliance costs of $0.7 billion in the quarter, you'd expect to trend up a bit from here? Is that what you're saying?

Iain Mackay

We do. That investment continues apace, and most of the investment is focused around the deployment of technology and automation into the countries in which we operate today. And as we get to that point, then, the overall cost of compliance we expect to be much more manageable, and possibly to see marginal – but only marginal – reductions in the overall cost associated with that. But the investment cycle continues through 2016, and we'll start to realise the benefits of that in 2017.

Manus Costello, Autonomous

I had a question about your AT1 issuance, please. There was a report in the press last week that the regulator had asked you to issue, and you had politely declined. I wondered if you wanted to comment on that incident, and more generally comment on what your calendar is like for issuing AT1, because you've obviously still got a reasonable amount to issue before you hit your target.

Iain Mackay

A regulator did not specifically request us to make issuance into the market, although a number of their investors did. I can well imagine their motivation behind that, considering the higher premiums that have been associated with those kinds of issuances back in January and February. Insofar as our AT1 calendar goes, we would expect – provided pricing is reasonably good, which it actually is at this precise moment in time, we would expect to be out in the market this quarter for AT1s, Tier 2s, and other TLAC-qualifying securities. We've got $10.5 billion out in the first quarter, and slightly higher spreads than we would necessarily have liked, but they came in quite nicely at the end of February and into March, so we got about $10.5 billion out. And certainly in terms of volume of issuance through the second quarter, it would be similar, or possibly slightly more, in the second quarter.

When you think overall about our programme of issuance, we've got, over the next three years, about $50 billion of maturity coming through for refinancing, and then on top of that we've got somewhere between $10 and $30 billion of new issuance to do to ensure that we meet the overall TLAC requirements by the beginning of 2019. And, clearly, our view is to try and get as much of a jump on that in 2016 as we can, provided the market conditions are reasonably supportive of that.

Manus Costello

In regards to the pressure on the net interest margin from that coming through, are you implying that should start from kind of Q2 if that $10 billion starts to bite?

Iain Mackay

We've put $10.5 billion out, and we'll be paying the coupons on that as time passes. The costs of issuing that paper – which, as we've described on numerous occasions before as surplus to our requirements – will create a little bit of pressure on the net interest margin.

Martin Leitgeb, Goldman Sachs

Just a few follow-up questions on revenues, please, and your comments obviously on Hong Kong and the loan growth outlook there is helpful. Just looking at slide 17, where you present underlying loan

figures on a constant currency basis, excluding the red inked balances, and the numbers there look fairly stable over the last five quarters, and I was just wondering if you could give us any view on how this could progress from here, with obviously particular trade balances potentially stabilising at the lower level. And in particular, I would be interested in your comments – one on the potential for loan growth within the UK and, in the UK, specifically mortgages.

Just looking at your disclosure, it appears that the deposit kept growing whilst the loan balances – at least on the retail side – kept fairly stable. Do you see the scope there to utilise your competitive funding advantage you have in the UK to engage in stronger mortgage growing in the UK here, going forward? And the second question on Trade Finance and the element related to commodity prices, with some of the major commodities having quite a rebound in the first quarter, could we see here trade balances expand going forward?

Stuart Gulliver

On UK mortgages, actually UK mortgage new business is up about 57% compared to Q1 last year. There's actually about a $2 billion increase in mortgages from new business. So, yes, we are trying to do that. We've signed up more third party agents in the first quarter as well, and we've also seen a considerable increase in the number of mortgages coming through on our direct channel, which is actually starting to pick up quite significantly. So, yes, we are focused on doing that; so our intermediary performance is up, new business is up, and the amount being on-boarded online is also up, so we are trying to do that.

If you come to your question about trade balances and commodity prices, yes, that should result in some kind of rebound. A big chunk of the documentary credit fall is related to softer commodity prices and, actually, just lower shipments taking place of commodities. And I think also the ability to grow the book in UK, Europe, North America and in Mexico, you can see in the first quarter that actually is where we've seen loan growth. Remember, also, running through these numbers – as we've set out on slide 17 – is going in the other direction; obviously, the reduction in the US legacy portfolios. So there is a net reduction going through as we dispose of this, as well, and as we dispose of legacy assets. So I think we're reasonably confident that we can continue to grow loans and advances, and that there is – as you say, there's a stable picture over the last five quarters. There's not a declining picture, and within which, we've basically offset the declines due to disposals of legacy positions.

Michael Helsby, Bank of America

On return on equity (ROE), slide 9, you know, your costs ex-Brazil – you're pretty much already out of your 2017 run rate, and despite that, when I look at slide 12, it shows that your group ROE, excluding significant items and levies, is just 7.6%. So I appreciate the revenue environment was challenged in the first quarter, but there's a trend where it's been challenged for a while. I guess the question for me is, 'What's plan B?' It really doesn't look like you're going to get anywhere close to your 'greater than 10%' ROE target, so can you come back to that $7.3 billion cost run rate and make it significantly lower?

Question 2 is on slide 15. You're talking about dividend growth and you're linking it to longer-term profitability. I asked this last quarter, and your shares are yielding more now since then; you know, it's 8%. Clearly, the market's very worried that you're going to cut the dividend, not grow the dividend, so my question really is: what's the longer-term earnings power that you would need to believe in for you to recommend that the Board does actually do what the market's worrying about and cut the dividend?

And then the third question is just on tax rate. The tax rate was 25.7% this quarter. You mentioned that was because of the UK surcharge. Should we use that now as the on-going tax rate on a clean basis? I just ask as consensus has only 23%.

Iain Mackay

On the last question, yes, I would use that 25% to 26% as an effective tax rate going forward, informed largely by the UK corporate surcharge on taxes.

I think on the ROE, just a couple of things to bear in mind. That ROE includes really the effect of Brazil coming through. And as we dispose of Brazil that adds about 13 basis points to reported return on risk

weighted assets, largely coming through the Retail Bank and the Commercial Banking businesses. And so that is helpful both in terms of the returns equation as well as the capital and the expense equation.

On the costs, you make the assumption that we're pretty much done on cost, and that simply is not the case. The $7.5 billion versus the $7.3 billion belies the facts that we've got continued investment to do relating to growth initiatives that focus on the longer term revenue generating and profit generating capability of the Group. It also focuses on the longer-term requirements for investment around global standards and regulatory programmes, and offsetting inflation. So there remains a very significant piece of work to do from a cost perspective. And delivering against that and exit run rate in 2017 equivalent to 2014, whilst continuing to build the balance sheet, albeit perhaps at somewhat slower rates should increment revenues as we work through. I think when you take those factors together, and hopefully, but not necessarily, planning for a little bit of assistance from US rates, then the mathematics would suggest we can move back towards that 10% rate and hopefully grow beyond that. But I think within the context of 2017, getting there is obviously a pretty difficult challenge. But that's what we're focused on delivering against, and a particularly strong focus on those things that are directly within our control, and then taking advantage of any revenue growth opportunities, for example those that Stuart laid out earlier on.

The guidance on dividends hasn't changed, and it's not going to change unless there's a culmination of factors relating to a wider recessionary environment in the markets in which we operate, or a significantly higher set of capital requirements. And as you know, notwithstanding various policy setters' proclamations to the effect that there is no Basel IV, there would certainly seem to be a Basel IV out there, with a wide range of re-assessment that's in the process of being consulted upon. So I think until we get capital requirements nailed down, which a year ago I was optimistic we'd be much closer to, but I think the events of the last few months have perhaps moved that out into the future, sadly. But the guidance on dividends hasn't changed. And if the underlying economic factors and performance factors do change significantly then we will certainly update you on that. But no change at this point.

Michael Helsby

I appreciate there's a lot going on in the cost line, but I guess what I'm trying to get to, if the revenue picture doesn't improve then clearly you're only left with one lever to get to your ROE, and that's cost. So I guess the question is to what extent can you lower that $7.3 billion run rate? Is it just off the table because it's too difficult, and you're working so hard to deliver that number in isolation?

Iain Mackay

No, it's not. But we'll make that determination when the time is right to make that determination. And two bad months at the beginning of 2016 aren't really the basis on which we'd make a decision that affects the long-term future of the Group.

Stuart Gulliver

We've had two difficult months, January and February, and two okay months, March and April. So there's not a trend yet.

Chris Manners

The first question is on slide 17, it looks actually to be pretty encouraging, the market share gains you're making. Could I ask you maybe just share with us which competitors are you taking share from? You don't have to name them, but maybe by type just to give us a sense. And also now that the volatility has stabilised a little bit after the first two months of the year, are the competition regrouping to any degree that you can see?

The second question was just going to be on the 'Other' revenue. That's something I always find it a little bit tricky to forecast. I was just looking at slide 7. Obviously plus $179 million this quarter. This time last year it was minus $200 million. The last few quarters have been roughly a negative number of $200 million-ish. When we think about that line going forward should that be a plus number, minus number, flat? How should we think about the other revenue trending?

And the last question was just on impairment. I thought it was interesting context you gave us on slide 18 there of where the impairment charges have been over time. I see you've put the time period back to

1997, and you've shown us some average impairments in percentages there. They seem to be a little bit ahead of where you're running at the moment. Shall we take from that you're expecting impairment charges to start creeping up a little bit, or how shall we interpret this?

Iain Mackay

Third question first, we wouldn't necessarily interpret anything from it. We provide it as information that hopefully is useful to you to give you some indication, certainly in absolute terms. In relative terms, although the impairment charges in the businesses that matter most to us have seldom risen above a significantly high level.

Stuart Gulliver

The other reason for giving it, is obviously fourth quarter – if you look first quarter of 2016 it's much lower than the fourth quarter of 2015, but actually much higher than the first quarter. So it's a volatile series. We wanted to show what the average was, because we thought we'd get a question as to what the average was.

Iain Mackay

In terms of 'Other' revenues, I'm not going to try and give you any guidance on the Other. The Other line picks up inter-segmental eliminations and consolidation within the Group. And it also picks up Group elements. And what we had coming through in that particular line in the first quarter was a bit of a hedge ineffectiveness coming through some of the parent company debt that was issued some time ago and interest rate and foreign exchange derivatives that have hedged the issuance of that debt. And when you saw some significant movements in both interest rate and foreign exchange in the first quarter, then that's really what flowed through in terms of the other income. So we had a positive effect of about $179 million in the first quarter, and that was largely from hedge ineffectiveness on those interest rate and foreign exchange derivatives against Holding company debt issued in recent years. And then a negative effect in the first quarter of the preceding year, which was largely on the elimination of intra-group items.

So it's got some volatility in that line, as you've seen coming through in recent quarters. But I think a significant amount – the ability to predict that is largely influenced by the very factors that we saw coming through this quarter in terms of movements in interest rate, foreign exchange and their impact on holding company debt.

Chris Manners

I was just going to say, would we be sensible to call that a zero, to model it going forward, just because it's volatile? It doesn't have an underlying run rate that it should have, basically, is that fair?

Iain Mackay

No, there's not an underlying run rate. It is not an easy item to predict until you start seeing effects coming through interest rate, foreign exchange and other market movements.

Stuart Gulliver

If you think about those banks which have changed strategy and pulled out of Asia, those are the people that we have taken market share from. So the easiest way to do it is by a negative. So the US banks remain highly competitive. But some of the other banks from other parts of the world have given up on their Asian initiatives.

Stephen Andrews, Deutsche Bank

Just coming back to the dividend again, just to work out what the actual cash payout ratio is at the moment. I think on slide 10 you said the dividend net of scrip, were about $2.1 billion in Q1. And I think you're including some of the preference shares in that. Am I right in thinking that the underlying payout was about $1.9 billion on the ordinary dividend, so the scrip take up in the first quarter on the larger final dividend for last year was probably in the 55% - 60% range?

And then the second question is on your ability to pay the dividend is usually a function of just the cash coming up from different parts of the Group. How should we think about – or how do you think about this slowdown in volumes in Asia? Sitting on the ground in Hong Kong it feels in some way structural, in that you're largely a US dollar lender, Hong Kong dollar lender. And with the RMB wearing, the demands you had coming from China for US dollar borrowing just isn't there anymore. Whilst that is having an impact on revenues, should we expect the Hong Kong/Shanghai banking court to be consuming significantly less capital than it was, so be upstreaming more capital going forward than it had done previously?

Iain Mackay

We account for dividends on an accounting basis within our capital. So the fourth quarter dividend was counted for in the capital ratios in the fourth quarter of last year. And the scrip take up on that was about just under 10% of the total, which represented about I think $440 million/$450 million in terms of cash contribution at the Group level. In terms of the upstreaming of dividends –

Stephen Andrews

Sorry, I meant on slide 10, the $2.1 billion dividends net of scrip, which I assume was for the full year dividend.

Iain Mackay

No, that's an assumption around net of scrip as it relates to first dividend declared.

Stuart Gulliver

So that's the first 10 cents per share.

Iain Mackay

That relates only to the interim for the first quarter, if you like, or the first interim dividend, to be more precise. In terms of dividend upstreaming from the subsidiaries we hold the subsidiaries accountable to upstream somewhere between 50% to 70% of their profit attributable after tax and that is applicable to all of the subsidiaries which are in a profit generating situation. Certainly as far as Hong Kong goes, like other major subsidiaries in the Group they obviously have to meet local regulatory requirements, which the Hongkong and Shanghai Banking Corporation does, comfortably. Again, the dividend distribution from the Hongkong and Shanghai Banking Corp is going to follow exactly the same principles as the dividend from ourselves to the ultimate shareholder of the Group. It's going to be informed by regulatory capital requirements, the profit generating capability of the business. And what you can clearly see is a business that continues to be very strongly capital generative.

Stuart Gulliver

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