Edited Transcript

Q1 2017 Earnings Release

Conference Call with Investors and Analysts hosted by Stuart Gulliver, Group Chief Executive

Corporate participants:

Stuart Gulliver, Group Chief Executive

Iain Mackay, Group Finance Director

HSBC

Stuart Gulliver, Group Chief Executive

Good morning from London; good afternoon to everyone in Hong Kong. Welcome to our first quarter results call. We've made good financial and strategic progress since the start of the year, and Iain's going to run you through the details shortly. Today's call will focus on the numbers, but there are the usual slides on our strategic actions in the appendix, outlining some of our achievements in the quarter, and I'll give a fuller update on strategic implementation with half-year numbers.

I'll now hand over to Iain to take the rest of the call before we go into Q&A.

Iain Mackay, Group Finance Director

HSBC performed well in the first quarter, relative to a challenging Q1 of 2016. Adjusted profit and revenue both grew as our global businesses maintained the momentum from the end of last year. Reported profits were down, due largely to a change in the accounting treatment of the fair value changes in own credit spread on our own debt. Last year's first quarter reported profit also included the operating results of the Brazil business that we sold in July 2016. Both of these items will feature in comparisons with 2016 reported results throughout 2017.

You'll recall that the difference between 'reported' and 'adjusted' is that adjusted performance excludes the period-on-period effects of foreign currency translation differences and significant items. Significant items are those that management and investors would ordinarily identify and consider separately when assessing the underlying trends, hence we consider that the adjusted measure gives a better indication of the period-on-period performance of the business.

Our three largest global businesses all grew adjusted profit before tax and achieved strong adjusted positive jaws in the first quarter. Global Banking and Markets had a very good quarter, with a large adjusted revenue increases in the major businesses. Retail Banking and Wealth Management also performed well, driven by rising interest rates, renewed customer investment appetite, the impact of market movements on our life insurance manufacturing business and strong wealth product and insurance sales across all categories. Rising interest rates and increased balances in global liquidity and cash management helped deliver improved adjusted revenue in Commercial Banking. Global Private Banking revenue was down on last year's first quarter after extensive repositioning in 2016, but stable relative to the fourth quarter.

We continue to grow lending in the quarter, particularly in Commercial Banking in Hong Kong and the UK. Our adjusted costs were higher than last year's first quarter but lower than the end of 2016, excluding the bank levy. We achieved a further $600 million of annualised cost savings in the first quarter, bringing the total annualised life-to-date savings to around $4.3 billion. We remain on track to hit the cost-saving target that we announced at our annual results.

Our common equity Tier 1 ratio strengthened to 14.3% and we completed the $1 billion share buy-back that we announced in February. We removed a further $13 billion of risk-weighted assets in the first quarter and have now exceeded the risk-weighted asset reduction target that we set in 2015. All three of our North American businesses delivered material increases in profit before tax and we made excellent progress growing our business in the Pearl River Delta and our insurance and asset-management businesses in Asia.

Looking quickly at some key metrics for the first quarter, the reported return on average ordinary shareholder's equity was 8%. The reported return on average tangible equity was 9.1%. On an adjusted basis, we had negative jaws of 0.6%, and we had a tangible net asset value per ordinary share of $7.08 which grew by 16 cents in the first quarter, driven largely by retained profits and foreign-currency translations. There is more detail on this movement in the appendix.

Slide 4 provides detail on the items that take us from reported to adjusted for the first quarter. Last year's reported results included fair value gains on the credit-spread component of our own debt, which we refer to as FVOD. This year, these movements are reported in other comprehensive income, following the adoption of IFRS 9's rules relating to presentation of these instruments. That means the income statement in the first quarter of 2017 includes no gains or losses relating to FVOD, whereas the comparable period in 2016 included a positive fair-value movement of $1.2 billion. This point of comparison will be a feature of all our reported results in 2017. This quarter's reported results also include $833 million of investment to achieve our targeted cost savings. You'll find more details of these adjustments in the appendix. The remainder of the presentation focuses on adjusted numbers.

Slide 5 looks at first-quarter profit before tax. Adjusted profit before tax of $5.9 billion was $641 million, or 12%, higher than the first quarter of 2016, driven by an increase in revenue and significantly lower loan impairment charges. The strong performance in Asia was driven by Retail Banking and Wealth Management. The year-on-year fall in profit in Europe was caused by a decline in profit before tax in the corporate centre. The main drivers of this decline were a fall in valuation differences between the Group's long-term debt and associated swaps, an increase in interest expense, principally due to increased issuance of MREL, and the non-recurrence of the UK bank levy credit booked in the first quarter of last year. Excluding the corporate centre, profit before tax in Europe grew year-on-year, with higher revenues on profit before tax in each of our three largest businesses, led by Global Banking and Markets.

Slide 6 shows the positive revenue trends in our global businesses. First-quarter revenue from our three largest global businesses was $1 billion, or 9% higher than last year's first quarter. Global Private Banking also showed progress on a quarter-by-quarter basis after extensive repositioning in 2016. I'll go through each business in more detail over the next few slides.

Slide 7 looks at Retail Banking and Wealth Management revenue, which grew by 15% in the first quarter compared to the same period last year. Wider spreads and balance growth in Asia and Latin American helped increased retail-banking revenue by $88 million following the Fed rate rise in December. Income from investment distribution increased by $110 million, reflecting renewed investor confidence and a $52 million rise from sales of mutual funds, retail securities and wealth-insurance distribution in Asia. Life-insurance manufacturing revenue increased by $394 million, reflecting $138 million of favourable market impacts in Asia and Europe, compared with $168 million of adverse market movements in last year's first quarter. We grew both customer deposits and customer lending relative to the prior quarter and the prior year, mainly in the UK, Hong Kong but also in Mexico.

Slide 8 looks at Global Banking and Markets, which grew revenue by 10% compared with last year's first quarter. Rates and credit rebounded strongly, up by 53% and 114% respectively. Global liquidity and cash management also performed well, with a 13% increase helped by higher balances. Foreign exchange revenue fell by 10%, reflecting reduced market volatility. Global Banking and Markets continued to reduce its risk-weighted assets in the first quarter, but it increased its lending, including term lending in Asia.

As slide 9 shows, Commercial Banking revenue was broadly stable. Revenue growth of 7% in global liquidity and cash management more than compensated for a drop in revenue in both global trade and receivables finance and credit and lending. Growth in global liquidity and cash management came from balance-sheet growth and wider spreads, mainly in Hong Kong. Global trade and receivables revenue was down compared to last year's first quarter, but stable since the end of last year with good balance-sheet growth. Loan impairment charges reduced markedly due to lower individually assessed charges and the net release of collective allowances, reflecting reduced exposure and lower loss rates relating to the oil and gas sector in the US, Canada and the UK.

Global Private Banking revenue stabilised between the fourth and first quarters. Revenue was down $37 million, or 8%, compared to last year's first quarter, following the repositioning of the business largely completed in 2016. We saw net new money in-flows in the first quarter of $4.8 billion in line with the strategy for the private bank that we set out in 2015. Corporate-centre revenue fell by $744 million, or 69%, compared to the first quarter of 2016. Balance sheet management had another good quarter, with revenue rising 18% to $845 million. Revenue fell overall due to minimal adverse fair-value movement of $32 million related to the economic hedging of interest rate and exchange-rate risk in our long-term debt, compared with favourable movements of $249 million in last year's first quarter. There was also a $215 million reduction in revenue from our run-off US CML portfolio and $176 million of higher interest expense in our own debt, driven largely by new issuance of MREL qualifying instruments. As we've indicated previously, we expect to complete the run-off of the US CML portfolio this year and to make good progress in reducing legacy credit.

Net interest margin of 1.64% fell by nine basis points compared with the full year or six basis points excluding Brazil. This was driven by an increase in the cost of funds of seven basis points, partly due to increased MREL required to make regulatory requirements and a fall in gross yields of one basis point. Gross yields benefited from the impact of US dollar rate rises on surplus liquidity in Asia. However, this was more than offset by the effects of base rate falls in the UK and from further disposals in the higher-yielding US run-off portfolio. First quarter net interest margin rose by four basis points compared with the fourth quarter.

Net interest income was broadly stable versus the fourth quarter of 2016, primarily reflecting the benefits from US dollar interest-rate rises in Asia and North America, contributing to higher net income on our deposit base and surplus liquidity. In addition, interest income rose as we increased lending balances, notably in Asia and Europe. These factors were partly offset by higher MREL costs and continuing disposals in the US CML run-off portfolio. We also reduced our average interest-earning assets during the period, primarily in low-yielding assets including cash, financial investments and reverse repos.

Slide 13 looks at operating expenses. We achieved further annualised cost savings of around $600 million in the quarter, bringing the total annualised life-to-date savings to around $4.3 billion. We remain on track to hit our cost targets and planned exit rate. First quarter costs were $186 million or 3% higher than the same period last year, mainly because last year's first quarter contained a UK bank levy credit of just over $100 million. There were also increases due to inflation, performance-related compensation and continued investment in our regulatory and growth programmes.

Slide 14 looks at loan impairment charges, which were down by $564 million or 71%. In the first quarter, gross charges were $1.1 billion, a reduction of $443 million from last year's first quarter. This included a reduction in individually assessed charges in both the Commercial Banking and Global Banking and Markets businesses. Releases and recoveries increased marginally from last year's first quarter to $788 million, resulting in a net impairment charge of $236 million in the first quarter. This included a net impairment release of around $100 million related to the oil and gas sector. In Mexico, there were higher charges in Retail Banking and Wealth Management, in line with our expectations as we continue to grow our market share of retail and consumer banking products. The credit outlook within our portfolio remains benign. This is in no small part due to the strength of our risk management and portfolio repositioning since 2011.

Turning to slide 15, the total reduction of risk-weighted assets since the start of 2015 now stands at $280 billion. This takes us above our original Group target on a currency adjusted basis. We removed a further $13 billion of risk-weighted assets in the first quarter. $7 billion of first-quarter savings came from our US CML run-off portfolios, $4 billion came from Global Banking and Markets and legacy credit, and $2 billion came from Commercial Banking. We'll keep removing lower-returning risk-weighted assets from the business and we'll maintain strong discipline on capital allocation through 2017 and beyond.

Turning to capital, the Group's common equity Tier 1 ratio was 14.3% on 31 March, compared with 13.6% at the end of 2016. Our common equity Tier 1 capital increased by $5.8 billion, of which $2.5 billion came from profits net of dividend and scrip, $1.5 billion came from regulatory netting and $1.6 billion came from favourable foreign-currency translation differences. The common equity Tier 1 ratio includes the full impact of the $1 billion share buy-back that we completed in April. During the first quarter, HSBC received updated indicative guidance on MREL requirements from the Bank of England, to be issued by 2019 and 2022. This is set out on slide 17. The final requirements may change due to a number of factors, although based on our understanding of the indicative guidance, HSBC currently meets its 2019 MREL requirement.

Slide 18 shows our Group return metrics. The return on average ordinary shareholder's equity was 8%, and the return on tangible shareholder's equity was 9.1%. Both of these are slightly down compared to the prior year, primarily reflecting the adversely movement in significant items. Excluding significant items and the bank levy, return on equity would stand on 10%, and return on tangible equity at 11.3%.

To conclude, we have had an encouraging start to the year. Our global businesses are performing well and our medium-term prospects remain good. Our growing Asia business is generating high profits and revenue, assisted by the strength of our network. We continue to do what we said we'd do: we've exceeded our RWA target and continue to impose strict capital discipline. We're also well on track to deliver our higher cost-savings target. We're committed to our regulatory and compliance programmes and to completing global standards to meet our requirements under the terms of our deferred prosecution agreement. We also continue to invest to grow the business. We're focused on delivering adjusted jaws in 2017. HSBC remains a well funded business with strong capital generation and a diversified balance sheet.

We'll now take questions.

David Lock, Deutsche Bank

First question on capital: I just wondered if you had or could share any update on how you expect buy-backs to roll out this year – given, obviously, your Core Tier 1 ratio is well above where you're targeting – if there'd been any update on the US process there, and if you had a core Tier 1 for the US business for this quarter.

And then secondly just on rate rises in the US, I just wondered if you could disclose or share how much of the kind of US rate rise from the back end of last year is already in the first-quarter numbers. So, should we expect a further improvement in future quarters from the more recent rate rise? Thank you.

Iain Mackay

If I take your second question first, the impact of the Fed rate increase in December is most certainly reflected within the numbers. And I think I commented specifically on how that was reflected in Asia and North America. I think, based on that improvement, we would expect to see the rate increase at the end of March come through in our numbers, as the year progresses as well. Clearly, deposit betas are different market by market, but we have seen benefit coming through in the first quarter from the December rate increase.

On capital and, more specifically, your buy-back point, David, no change to the guidance from the mid-year and the end of last year. We completed $2.5 billion in the second half of last year. On 12 April, we completed $1 billion. Our priority for capital is to invest it in the growth of the business. Clearly, the focus is to generate profits that support the dividend, and we've given clear guidance on what we expect the dividend to be in 2017, and we'll consider buy-backs from time to time. We're going to take a pause now. As we get through the first half of the year, we'll reflect on that, obviously reflecting on capital and where we are from a regulatory perspective with the PRA.

David Lock

Do you have a Core Tier 1 ratio for the US entity?

Iain Mackay

Yes, those details will be published at 10.00 a.m. today. But what I can tell you is at the beginning of April we received the first dividend from our US businesses in 10 years.

Ronit Ghose, Citigroup

I just wanted to drill a little bit into these results. And overall, obviously, I'm sure they're very pleasing for you, and they're good numbers. If I look at the loan growth in Asia, and Hong Kong in particular, the 3-4% loan growth you saw Q on Q, sequentially, could you just give us some more colour around that? How many sort of one-offs do you think are in there? How sustainable is this? Is this any sort of Chinese mainland credit tightening spilling over into Hong Kong, pushing Hong Kong growth? Any kind of forward-looking colour would be great.

And specifically on margins, I've seen all the disclosure on NII sequentially, quarter on quarter. I don't know if you can break out for us. The margin quarter on quarter went up. If I look at the underlying trends, how much positive was there from US rate rises offset by other factors like asset spread reduction and higher funding costs?
And, finally, the third question is TLAC/MREL. Previously you've guided, I think, $500 million impact on NII. In today's release, you're saying it probably won't be as big. I just wonder if there's anything further you can comment on that.

Iain Mackay

I'll take those in reverse order. So, on MREL, we've put the guidance on the charts for you. But we have glaringly obvious caveats there, because this is the Bank of England providing guidance. This is not guidance from our other regulators around the world. This is clearly very helpful. We believe, based on this guidance, that this would tend us towards the lower end of the 60-80 billion range that we talked about in terms of MREL and that achieving the lower end of that range is probably over a longer period of time, out to the end of 2021. So, I think in that regard it would certainly indicate a lower interest expense associated with lower issuance of MREL over that period of time.

With respect to net interest margin, what we've clearly seen coming through our businesses is continued pressure on spreads from an asset perspective but some expansion coming through the liability spreads, and that's largely informed where we see dollar and dollar-linked currencies, so we've seen that in the US; we've seen that in Hong Kong to a certain degree as well. In terms of the four basis point improvement from the end of last year, it is very much driven by spread expansion within the businesses – so, encouraging.

On loan growth in Asia, Hong Kong Commercial Banking has seen balance growth in global trade and receivables financing. And the last couple of years it's been a tough place to be in terms of declining activity within global trade and receivables financing. Noel and the teams in Asia saw stabilisation within those numbers, good balance growth, a little bit of spread compression on those balances – but overall an encouraging picture in that regard. We also saw balance growth in the United Kingdom coming though Commercial Banking, Global Banking and Markets, Retail Banking and Wealth Management. And, again, reverting back to Asia, we've seen Global Banking and Markets grow balances as well.

So, I think put this a little bit in context. I certainly wouldn't want to talk this down, but you will recall the first quarter of last year was a tough one. We've taken some of the balance growth we saw coming through in the fourth quarter, which was good momentum, and carried that into the first quarter. So, it's certainly encouraging not only in terms of what we see coming through the income statement, but the balances we see coming through in some of our key markets in the first quarter as well. We have continued focus on repositioning and rebuilding our Mexican business – good progress in that regard in the first quarter. And, again, I think our Canadian business continues to progress well. So, overall, an encouraging picture on balance growth.

Ronit Ghose

Can I just pick up on the loan-growth point? So, pretty strong on CMB – I get that. On RBWM, particularly if I take out FX adjustments, it looks like – compared to what you're seeing elsewhere in your franchise – the RBWM underlying numbers didn't look that strong. Am I being too nitpicky or is there anything else going on there? Have you taken your foot off the mortgage pedal a little bit?

Iain Mackay

FX-adjusted, balance growth is about 1%. So, its growth, but it's at 1%. We've grown market share in the UK. We've got risk appetite for that, but we are very focused on high-quality product in that area. 1% is the growth we saw coming through in Retail Banking and Wealth Management in the first quarter.

Stuart Gulliver

And remember it always takes more time to actually drive the RBWM asset book to growth, because the individual loans are obviously much smaller than either Commercial Banking or Global Banking and Markets.

Alastair Ryan, Bank of America Merrill Lynch

Margin and capital again, please. Thank you for the new disclosure on the net interest margin. It's very helpful. Is it too much to ask whether you've turned a corner? Clearly, it's been a long time coming down. A lot of the things you're doing should make it start going up again. Is that something you'd guide us to yet or is it too early to tell?

Secondly, 70 basis points – about $6 billion of free cash flow in the quarter, which is a great number. Is there any reason why you would be changing your target range for capital, or your expected range for capital, which you're now well above? I take the point, you know, that we shouldn't become buy-back junkies, but it certainly looks like there's more capital generation than you can reasonably expect to put to work, even now you're growing the book again. Thank you.

Iain Mackay

On net interest margin, I think I'd go back to my earlier comment. In terms of liability spreads, what we've seen coming through the Fed rate adjustment has been encouraging both in the US and other dollar-linked currencies, most notably in Hong Kong. On the asset side, there's still a lot of liquidity chasing deals. We still see pricing pressure on asset spreads. I would be inclined to kind of keep a pretty consistent view broadly in line with guidance that we provided at the end of the year in this regard. Encouraging signs but I think we're going to stick with the guidance that I think we provided at the end of the year – but hopeful. And clearly, Alastair, if the Fed were to become even more helpful than they've already been and get another rate increase or two out there this year, I think that clearly would be further signs of encouragement from our perspective.

On the capital front, no intention to change the target range of 12% to 13%, but, as we said previously, a clear preference to operate at the top end of that range in the medium term. We also said earlier that in the medium term we're going to operate above the top end of that range. I don't want to go down the regulatory rabbit hole on this one, but there are, obviously, a number of factors out there that we still need to work through. Basel III revisions will come upon us at some point. Hopefully they'll have no impact, but it's an unknown at this point in time. IFRS 9, on which we'll provide more guidance at the half year, we would expect to have some impact – although probably not major.

And, again, I think we're sort of living in an interesting period. Let's call it that. So, having completed $3.5 billion of buy-backs in the last six months and good profit generation in the first quarter building the capital ratio, the guidance around how we deploy that capital remains consistent. It's about growing the business. You make a good point around our capacity to deploy all of that. It's very much about generating profits that support the dividends, and we'll think about buy-backs periodically. But we won't be revisiting this, at the very earliest, until the first half.

Rohith Chandra-Rajan, Barclays

Returning to net interest income, but, actually, on the average interest-earning assets – just to comment on the slide that… There was some reduction as you took out low-yielding assets. I'm just wondering if you could clarify whether that's fully worked through in the Q1 number or whether that'll be an ongoing headwind into Q2.

And then, secondly, on non-interest income, which was clearly a very strong performance, I guess, supported by Wealth and Insurance in RBWM and a trading performance in GB&M. I guess a couple of things caught my eye there. Number one, obviously, was that the market impact on Insurance we'd probably assume wouldn't repeat that 138 million, and then BSM also had a good quarter, so I was just wondering if you could talk about the sustainability or underlying trends in non-interest income. Thank you.

Iain Mackay

Yes, we'll talk about your average interest-earning assets point first. I think that's probably a discrete effect within the first quarter. You know, we're always going to see movement across different classes of assets and liabilities within the balance sheet as our customers reposition, so I wouldn't necessarily say that's something that we're going to see recur every quarter, but I'd probably take it as being fairly discrete.

From a non-interest income perspective, sorry, repeat your question a second.

Rohith Chandra-Rajan

It was really about the sustainability of non-interest income. So, it was obviously a strong performance from GBM and, I guess, the Wealth and Insurance bits of RBWM and sort of – and I guess a couple of things stood out. One was the market's impact on the Insurance business and also a strong BSM, so I was just wondering if you could talk about underlying trends and sustainability in non-interest income.

Iain Mackay

Look, so BSM, very strong quarter. Within that $845 million of revenue, we had about $100 million of AFS gains. There is absolutely variability in that quarter on quarter, so I would not annualize that first quarter number in BSM. Our guidance around BSM remains absolutely consistent in terms of that $2.5-3 billion per annum.

In terms of the variability within the present value in force accounting within the Insurance Manufacturing business, you track back as many quarters as I can count and you see variability from market movement. In the first quarter of last year, with a pretty miserable sort of environment to operate in, we saw negative adjustments coming through. In the first quarter, we've seen positive adjustments and that's obviously contributed to a swing of more than $300 million in the quarter. If you take that effect out of the Retail Bank Wealth Management revenue growth, the adjusted revenues grew 8%, so of the 15% growth about 7% came from those market movements within Insurance Manufacturing, about 8% coming from current accounts, deposit accounts, retail brokerage, wealth management product sales. So that's a good performance coming through the Retail Bank Wealth Management, much of that orientated in Hong Kong, but also coming through the UK business.

Stuart Gulliver

And on GBM, so you know the nature of the Global Banking and Markets business, but what I would point you to is we break out somewhere in one of the appendices the quarterly revenues of Global Banking and Markets, and you will see that they are not that volatile. So, actually, GBM had a great first quarter, it was their strongest since the first quarter of 2014, and in terms of concern, you know, is it repeatable, clearly it's not an annuity business but – in its entirety, but it contains a number of annuity revenue streams in terms of trade finance, in terms of security services, GLCM, etc. So, if you look at the revenue numbers of GBM overall, you find, quarter on quarter, it's quite consistent, it actually hasn't got the variability of many of our competitors. So, it was a great first quarter. No, you can't multiply it by four, but I'm not sitting here concerned that it will all evaporate again at all.

Chris Manners, Morgan Stanley

The first question is, as I remember, last quarter you put up a slide sort of highlighting some of the headwinds that you were expecting to revenue growth and you had the two billion from FX, if we use January exchange rates, for example, also, you know, the UK curve. You know, could you maybe update us a little bit there? I suppose that we've actually had, you know, some of your – you know, obviously, cable moved with the stronger pound, you know, some of the emerging market currencies have moved. Could you maybe update us on those headwinds, because presumably they will have abated a little bit and I noticed you didn't put the slide – those comments in again?

And the second one was on the impairments. Obviously, you know, 11 basis points is fantastic to see and, you know, obviously you had writebacks in the US and Europe. But, you know, when we look at your slide, you say you have gross impairments of 49 basis points; that sounds relatively high. You know, where should we be expecting that to trend over time and what would you see as a sort of, you know, a normalized writeback rate, as it were? Thanks.

Iain Mackay

So, what we have done this quarter, and we'll decide later whether we'll repeat this, is that we've broken out the gross and net for you in terms of loan impairment charges, recoveries and releases, to provide a little bit more detail around that. But if you were to take the consistent reporting, it's the 11 basis points that you look at. I would not only not encourage, I'd discourage anybody from multiplying that out by four and assuming that's the rate for the year, as I'm sure none of you would dream of doing. I think you always have to look at the longer trend performance and if you track back, whether it's eight or 12 quarters, to give you a better sense of how to predict the future, because it's impossible to really tell. But good loan impairment charge experience in the first quarter. Clearly, we saw recoveries coming through from higher provisions that we made in the Q415, Q116 in the oil and gas and metals and mining sector, and we saw sort of a net recovery of about 100 million coming through the oil and gas sector, principally the UK, Canada and the United States, which clearly aids the numbers in this respect. But overall, loan impairment charges coming through Commercial Banking, Global Banking and Markets were lower in the first quarter. There are really no clear indicators out there of credit quality deterioration across our portfolios. In Retail Bank Wealth Management, we saw slightly higher provisions. Part of that's informed by Mexico, where we continue to rebuild the business and grow our share of retail banking and consumer finance products, as well as in the UK, where we had a small methodology adjustment coming through. Not indicated by higher delinquency, but just a methodology adjustment within the UK business, but it was a very small number. That's really the story on loan impairment charges.

In terms of revenue guidance, Chris, I would keep with what we talked to you about at the end of the year. I mean, clearly there's been a little bit of a change in cable rate, but I think the thing to think about is the two billion correction that we put around thinking about overall position on an FX-adjusted basis for revenues. The bank rate in the UK is still feeding through and we'll see that for another few months. I think the other thing to factor, which we are guiding on today, is an expectation, based on the guidance from the Bank of England, that we'll have lower MREL issuance over the coming years and that would translate through to an expected lower interest expense in that regard.

Raul Sinha, JP Morgan

If I can have a couple, please, as well. Just to go back on the loan growth, if I may, some of the rates of growth are very, very strong in Asia and one of the things that stands out as a highlight clearly is Pearl River Delta, which you did promise us you're going to grow very well, but the mortgage book there looks like it's up 54% and Commercial Banking's obviously up 20%. So, could you maybe talk us through as to what is driving these very strong rates of growth? Is it just kind of you stepping up distribution and taking market share or is there really kind of underlying growth? And just if you can touch upon the credit quality element of that as well, that would be really helpful.

Iain Mackay

So, as you can imagine, clearly early days, from a credit quality perspective. We're building a book from very low balances within the Pearl River Delta. You're absolutely right, we've got good growth coming through; that's about having feet on the ground and distribution capability. Late 2015 and 2016 was very much about investment in that capability and that's what Helen Wong and the team in the greater China area are now driving. So, very encouraged by what we see, but too early to really talk about how that performs from credit quality, but I can say that the underwriting standards that are being applied in Pearl River Delta are entirely consistent with what we see in Hong Kong and the greater China area, so I think we're pretty confident about the quality of what we see going on there. Global Banking and Markets grew nicely in terms of Asian balances and Commercial Banking as well.

So, look, the focus, you know, we've talked about this for two years, about – go about taking capital through RWA reductions and being able to redeploy that back into our markets that demonstrate a great propensity for profitable growth, and our Hong Kong, mainland Chinese and Asian markets are those where we're going to try and deploy more capital. It absolutely does not exclude our focus on rebuilding the Mexican business and growing the UK, European and Americas' businesses, but the strength that you've seen in Asia is built on momentum that we established in the fourth quarter of last year and which has been encouraging in the first quarter.

Raul Sinha

Can I get an update on BoCom and the value in use? I think last time we discussed, the headroom was quite limited and I was wondering if you might have written up, after BoCom's results, the VIU.

Iain Mackay

The headroom is about $200 million right now, so it's a little bit less than it was at the end of the year. The guidance on BoCom is absolutely consistent, Raul. I mean, the accounting on this one, as you know, is interesting. If you want a refresher on that, go back to the annual report and accounts, where we've got the better part of a page and a half of disclosure around the assumptions in the model, the sensitivity in the model to changes in those assumptions. You know, we've been talking about the risk of VIU and carrying value converging and crossing over for the last two or three years, but guidance is consistent on that and I'm happy to refresh you on the detail of it once you've had a chance to reflect back on the annual report and account guidance.

Raul Sinha

I just want to check if the VIU went up; it sounds like it has gone up if the headroom's, because you have obviously recognized.

Iain Mackay

Well, obviously carrying value goes up each quarter, because we recognize our share of profits under the equity method of accounting and VIU. So, the gap is: the VIU, in total, is $16.5 billion and the carrying value is $16.3.

Tom Rayner

On the margin guidance, I'm just trying to get a sense for why you're being so cautious now. I mean, you've got 164bps sort of in the bank, so to speak, in Q1, so you'd have to see the margin down at sort of 152bps, I think, for the rest of the year to not beat your guidance. I'm just wondering is there anything else, such as maybe a sort of passing through of the rate rise to your savers more than we've seen so far? Is there anything specific that's making you repeat the sort of existing guidance or are you just being – just being cautious? And I have a second question, please.

Iain Mackay

I think, at the moment, there is a little bit of a disconnect, as you've probably observed, between HIBOR and LIBOR rates, and that's a little bit in terms of RMB balances still flowing into Hong Kong Dollar balances, which is keeping HIBOR at a lower level. Deposit base, as you know, in the US we compete very actively for deposits, so the base there is a little bit harder than we presently see in Hong Kong. I think it's just early days. We're certainly encouraged by what we see and we'll provide more guidance about this when we come to you at the half-year, hopefully.

Tom Rayner

I know you said you're going to update us on IFRS 9 at the half-year; is there anything you can say broadly about sort of the issues about not only the day one impact on capital but how you view the procyclicality of the Accounting Standard, how that might affect your reporting, how regulators might think about the impact of IFRS 9 in terms of adjusting the capital ratios, the RWA calculation, whether the stress test might have a sort of perverse impact? Is there anything more broadly you can say, at this stage, about the Standard?

Iain Mackay

I think it absolutely presents challenges, not so much to adoption. Adoption, I think, is – you know, the complexity that we add through this standard, building models, multiple economic forward-looking scenarios, transitions from stage one to stage two, I mean, you know all of this stuff well. It's not so much the transition which I think presents challenges, it is working through the credit cycle and the volatility and the procyclicality that may present as you see significant credit deterioration, how that affects portfolios and how you move from 12-month loss experience to a lifetime loss experience. So, I think, you know, one of the really important things about IFRS 9 implementation is about getting the disclosures right: when we see movement from stage one to stage two, what's driving it, getting to a clear understanding of what that really means about the credit quality within the portfolios. You know, if you look at what the teams have done over the last six years in terms of repositioning credit portfolios, strong credit risk management across the businesses, you see that reflected in our loan impairment charges, the overall credit quality of the book. Now, how do you take that on implementation of IFRS 9 and then envisage, for example, a repetition of the deterioration that we saw in the oil and gas sector in 2015? And then how do you write that up in terms of what that means for the fundamental credit quality in the portfolio? So, we're absolutely adding complexity through this standard and you chaps know this much better than I do, but adding complexity doesn't engender greater understanding of financial statements and performance in a business.

So, I think the most important thing about this standard, from an implementation perspective, is the quality of the disclosures and the insights that we provide to the users of our financial statements as we implement it. The implementation is very much on track. As you know, there's a ton of work to be done by the industry in this regard, but life is going to be a little bit more complicated for users of financial statements.

Stuart Gulliver

And just to echo that point, just on the specific thing of stress tests and, again, Iain's point's right on the mark, which is the disclosure will have to be much greater, because the impact will be to tend to make the effect of stress tests deeper and sooner. So, they'll bring it forward in time and make them deeper and, therefore, the year-on-year comparisons will need to be completely unpacked to stop, if you like, false conclusions being drawn. So, it's really going to be about how much disclosure can be put out there to make sure that the reaction of the market is well informed.

Iain Mackay

Yes, and I think, building on Stuart's comment there, I think one of the things that is helpful in terms of what the PRA is doing around their IFRS 9 stress testing module coming a little bit later than the annual cyclical stress and the biannual exploratory stress is that, you know, it, hopefully, helps separate out and isolate some of the IFRS 9 components and then provides information to regulators about what the potential impact on capital is.

You know, there is an interesting challenge here more widely, with respect to the prudential regulatory regime for capital in IFRS 9. The opportunity to maintain consistency within the regulatory capital regime is absolutely clear. Today, you take the difference between expected loss and your allowance for loan losses and if expected loss is greater than ALLL[1], you deduct that from your capital ratios. If you want to neutralize the impact of IFRS 9 and, in actual fact, demonstrate confidence in the regulatory capital regime, if ALLL were to exceed EL, then you would add it back. And that, at least through some transition period until the market regulators and preparers of financial statements become adept at understanding how to properly reflect, report and inform movements in credit quality through IFRS 9, that's certainly something that we would advocate. But I do think the approach that the PRA is taking to the IFRS 9 module for stress testing will be helpful in terms of informing, from a capital perspective, what it may do in significant periods of credit stress.

Manus Costello, Autonomous

I have a couple of questions as well, please. I wanted to ask, first of all, about the impact of rates away from the Fed, in particular in Hong Kong. I wonder if you could talk about how important it is to you that HIBOR starts to go up and how meaningful it would be if HIBOR – it drifted down during the course of the quarter, how significant is that in terms of your NII assumptions? And do you need the best rate in Hong Kong to move up to really start to capture some of the full benefits of higher rates?

And my second question is just a simple one on revenue guidance. You're quoted, Iain, on the newswires this morning as talking about looking for 3-4% revenue growth during this year. Can you just clarify off what base that comes from and what the key drivers are that are going into that assumption?

[1] Allowance for Loan and Lease Losses

Iain Mackay

Yes, absolutely, so, the guidance this morning was off how we rebased you at the end of the year, okay? So, if you think about some of the guidance we gave around the end of the year, and Chris brought this up earlier, particularly around the FX impact there of approximately two billion, and that – and then rebasing the 3-4% off that point was what I was referring to. So, apologies for lack of clarity on that front earlier this morning.

In terms of rates, clearly there is a little bit of dislocation between HIBOR and dollar LIBOR in Hong Kong right now. Getting better linkage between those two would clearly be beneficial. I was just reflecting on this earlier in the week with our team. Part of what seems to be driving that is that we do see flow from renminbi deposits into Hong Kong dollar deposits and that's keeping HIBOR at a lower rate. So, getting better linkage around that would bring more benefits. We have seen benefits coming through deposit spreads in Hong Kong on dollar deposits in the first quarter. Better linkage HIBOR-LIBOR would absolutely help that further.

Manus Costello

But if HIBOR is lower in Q2 than it was in Q1, might you actually see some NIM pressure in Hong Kong?

Iain Mackay

I don't think so much it's NIM pressure, it's just less pickup, I think, is what we would anticipate.

Stephen Andrews, Deutsche Bank

A question on capital again. I'm just curious as to, you know, why you're not feeling more comfortable in terms of extending the buyback programs now. Is there something specifically you're looking for, given how much headroom you've got on capital?

And then, secondly, related to that, just on the North American business. That's obviously where a lot of your RWA reduction in the quarter has come from, I think it's about $10 billion, and that shows up in the US bank accounts as well. If I just filter that through, I know we don't have the North American HoldCo numbers yet, but it looks like that could have ended Q1 with a sort of 19, 20% core equity tier one, just aggregating up the numbers, which means you've probably got about $7-8 billion of excess capital in there, which is most of the Group's excess capital. How should we think about that moving upstream? I know you said you're taking a dividend out, which you sort of flagged you hoped you'd do last year, but has there been a shift at all, I would say over the last three or four months, in terms of how quickly or slowly you might be able to get that capital out of the US or is it still pretty much as you thought.

Iain Mackay

Really no change. We never had an expectation that we would get a dividend before the first half of 2017. We filed the 2016 CCAR around about this time last year, got no objection to the capital plan from the Federal Reserve, which was extremely helpful, and we upstreamed dividends from the US subsidiaries into the parent company group in early April of this year. So, that was the first dividend from the US subsidiaries to the parent company group since 2006, so we're encouraged by that. Your calculation, broadly speaking, is accurate in terms of the amount of surplus capital that sits in the US and that is, by a long stretch, the single largest pocket of surplus capital within subsidiaries within the Group. And in terms of upstreaming, we would still expect to take this, because of the quantum, because of the CCAR cycle – it is an annual cycle and the capital plans have to be reviewed as a part of that, we would still expect this to take three years plus.

Stephen Andrews

Does the DPA at all impact on the ability to get capital out of the US or is it kind of unrelated?

Iain Mackay

Look, the decisions around the DPA are made by the Department of Justice. I think we would probably be a little bit naïve that when regulators in the US reflect on capital strength that they don't reflect on everything that impacts our business in terms of both financial performance and regulatory compliance. So, you know, we can't read the minds of the Federal Reserve, but I think it would be unusual that the DPA's existence does not bear somewhere in their thinking as they reflect on the capital position of the Group in the United States.

Robert Noble, RBC

I was just wondering if you could expand a little bit further on the deposit beta that you're seeing, split by retail and corporate and geography and how you expect those to change over time if rates follow the forward curve, as we expect.

Iain Mackay

Yes. Deposit beta, I mean, geographically, if we pick out the US, we compete actively for deposits in the United States and the beta is, broadly speaker, higher in the United States than it is in other markets. It's relatively low in Hong Kong at this stage, and you would imagine that to be at the case. If you look at the AD ratio in the Hong Kong market, it's about 50%, a little over 50%. That will evolve over time in terms of pay away to customers. As interest rates build, we would expect to pay proportionally a little bit more of that away to our customers. When you then think of the contrast between retail and commercial, the bases in commercial are higher; we tend to pay away more to the commercial customer and, again, that's competition in different markets and also a recognition that some of the commercial deposits tend to be behavioralised to a shorter duration than is the case within the retail portfolio. So, that's broad guidance, but it's pretty dynamic in terms of how we set deposit pricing by our various businesses in the various markets. It's very much driven by market by market, local dynamics.

Michael Helsby, Bank of America

I've just got a clarification and then a couple of – sorry, a few questions on the UK. Just on the clarification, Iain, on the revenue base that you're referring to, sorry, I get the FX point, but does the base include the TLAC and the CML and the rate adjustments that you were referring to at Q4 or am I just simply deducting the two billion FX impact?

Iain Mackay

It's the FX.

Michael Helsby

What was net UK mortgage growth in 1Q17?

Iain Mackay

$1.5 billion

Michael Helsby

What % of the UK mortgage book is on the standard variable rate (SVR)?

Iain Mackay

c7%

Michael Helsby

Right, okay. And clearly, you know, there's been a lot in the press about the unsecured market in the UK and obviously the Bank of England are looking at it. Can you just update us on how you're approaching unsecured at the moment? Whether you've backed off in that area.

Iain Mackay

No, we'd like to grow in unsecured, but, you know, in conversation with John Flint earlier this week, cautiously, with a focus on the segments that we're entering into. So, clearly, in terms of diversification within the Retail Bank Wealth Management business globally, we've got very strong, you know, well underwritten mortgage portfolios. We tend to be underweight in unsecured and that would be the case in really all of our key markets with, possibly, the exception of Hong Kong. So, John and the team do have a focus on growing our share of unsecured, but given some of the comments that you made there, Michael, there is caution around how we do that in terms of quality of underwriting and understanding the customers we're onboarding.

Michael Helsby

And then just finally on the UK, I think, from where I'm sat, the Brexit negotiations probably couldn't have got off to a worse start if they'd have tried and it does look like the chances of a very hard Brexit look like they're increasing. So, with that regard, I was wondering if you could update us on how you're planning for this, what the potential disruption could be and what you can actually do to mitigate it. I'm just conscious that you're having to submit plans into the Bank of England, so anything you can help us to understand that, that would be great, thank you.

Iain Mackay

No change on that front. You know, what you've heard Stuart say and Douglas say in terms of possibly having to transfer up to 1,000 employees to our French universal banking platform based in Paris, and that's based on a very detailed, product by product, client by client, revenue line by revenue line analysis performed earlier this year. So, that guidance will not change and it is up to 1,000 and that will be informed really by how the shape of a Brexit negotiation takes place and what that means for financial services and supporting customers. So, the focus clearly, from our standpoint, is to be in a position to support customers across our different global businesses seamlessly, as we work through Brexit. And, you know, that may mean that we have to transfer up to 1,000 of our staff to upscale the capabilities within our French platform at this point. But that analysis was based on a hard Brexit outcome and, therefore, I don't think we're going to be updating guidance on that, certainly based on what we know at this point in time.

Martin Leitgeb, Goldman Sachs

One question really just from my end. Over a couple of the last quarters you keep surprising positively on capital progression, and so I just wonder: how should we think about capital progression going forward? I think there's a couple of elements to that question. Obviously the first one is in this quarter you had good progress on increased netting. Is there more scope to do so? And equally, you mentioned in the presentation that you have achieved your RWA reduction target now, pretty much, and there is further scope for further cuts going forward. How should we think of that? Should we think of that progressively becoming smaller in terms of number or would you expect the current pace to be roughly maintained going forward? Thank you.

Iain Mackay

I think as we commented previously, from a netting perspective we've probably achieved a pretty optimal perspective. We always look at opportunities to improve collateral management, but I think we've largely emptied that bucket at this point. From an RWA reduction perspective, notwithstanding the fact that we've achieved the target, we still have work and opportunity to do. This was never about reducing the balance sheet of HSBC, but it was very much more about capital discipline and deploying that capital into lines of business and with customers that deliver pounds per shareholder. And that recycling of capital, whether it be in Global Banking or Markets, Commercial Banking, Retail Bank, will continue, and it is about maintaining that capital discipline well beyond 2017 and beyond achieving the target that we have already achieved. On the netting front, good progress, but that game is probably largely completed. On the wider opportunity for continuing to improve capital efficiency, the allocation of that capital into profitable business is where the focus will continue.

This concludes this morning's call, so thank you for your time.