Transcript

Post Q3 Results Analyst Meeting

Meeting with Analysts hosted by Iain Mackay, Group Finance Director

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Corporate participants:

Iain Mackay, Group Finance Director
Richard O'Connor, Global Head of Investor Relations
Kathleen Gan, Chief Financial Officer, Asia-Pacific
Gavin Francis, Group Chief Accounting Officer

HSBC

Iain Mackay

Welcome to the post-third quarter results analyst catch-up. Since Asia contributes 70% of the group profits, I think the first question should come from Hong Kong.

Gurpreet Singh, Goldman Sachs

We made some calculations based on available disclosure. Did Hong Kong margins move up in the first quarter? What is the first half average? That's the first question, and the second is more on loan growth. UK and Hong Kong continued to have very good loan growth year to date, so what do you see – what do the businesses see – for the rest of the year and into 2018?

Kathleen Gan

From a NIM perspective, Asia did go up in the third quarter in terms of NIM compared to second quarter, and also against the prior year, again, I think, largely driven by some of the common themes we talked about yesterday. The deposit margin is very strong from the US dollar deposits, and that more than offset some of the margin compression we've seen on the lending side. That's pretty much the major trends that you're seeing.

Richard O'Connor

Q3 was up two basis points.

Kathleen Gan

That's right.

Raul Sinha, JP Morgan

Can we maybe stay on margins, and I've got one on capital. The group NIM went down in Q3, and I was on the call. Iain, you talked about how one basis point of that was from the UK margin from pressure on the mortgage side. Can I invite you to talk about whether, as we go forward, the group NIM can actually move up a lot from where we are today, subject to the rate environment, given that you're going to start to grow you're UK mortgage book from the end of the year levels, which would be quite margin-dilutive?

Iain Mackay

We have been growing the mortgage book, probably for the last two and a half years, and I mentioned yesterday that I think for each of the last few quarters, we've seen a little bit of margin compression coming through the asset side in the UK on mortgages. Overall, NIM in the UK has been adversely impacted by the Bank of England base rate move in the summer of last year, which we saw adversely impacting net interest income and net interest margin.

In terms of continuing to grow that book, again, building on the comments yesterday, the UK mortgage book is pretty well diversified by LTV. It is very prudently underwritten, where the higher LTV products tend to have a lot of support behind them from an affordability perspective, in terms of the propensity of a household to withstand higher rates of interest coming through and other forms of financial distress. But, yes, there is some price erosion coming through. The balance that the retail bank and within that, the ring-fenced back, going forward is going to have to balance is the desire to grow versus the profitability of that product.

So the criteria that we have in front of the businesses is return on risk-weighted assets translated into return on tangible equity – and we'll talk more about what that means for each of the businesses at the end of the year – and then ensuring that business we write is covering the hurdles from a cost of capital perspective for the Group. To continue to grow the product whilst it continues to be accretive from an earnings perspective for the Group, we're absolutely happy to do. To grow a product which is not accretive makes no sense, and I think that's something that Stuart Gulliver's been very focused on. It's something that John Flint is going to be very focused on.

So, yes, it's a product line we like. It's a profitable product line for the Group. It has meant we have seen some asset margin compression coming through that book as we've grown over the last couple of years. It's been pretty marginal. It's a book that continues to perform extremely well from a risk-adjusted revenue perspective. I think that point is well into the future, but there is a point at which we'd have to make a trade-off decision between volume and margin. So being bigger with lower margins is not necessarily our goal here.

Raul Sinha

But are you signalling that there's an acceleration in the pace of that book ahead with the intermediary platform?

Iain Mackay

No. We grew the business 2 billion sterling and our market share – we've got to take a good look at the market share data - but the market share's probably around 8%; that's grown from where we were at the end of last year, which was just over 6%. That's made up of both the indirect channel, which we're seeing more, and the direct channel through the branch network, where we think we see about 20% of the market. So whether the pace of growth accelerates or flattens out, is going to be informed by a whole range of factors, one of which will be our risk appetite and the profitability that the product informs.

Richard O'Connor

Over the last 12 months, we've grown our loan book by $69 billion: $60 billion in Asia, $48 billion in Hong Kong, and $9 billion in the UK. Mortgages are important. We've grown quarterly growth from $2 billion to £2 billion sterling, but we've grown our Hong Kong mortgage book by a net $2 billion a quarter, so it's an important product, but it's one basis point, not five or 10 basis points. We can obviously talk about competition in Asia, but from what I'm picking up it's actually stabilised a little bit in the last few months.

Raul Sinha

Is the new business in Asia more dilutive than the new business in the UK?

Iain Mackay

No. That was exactly Kathleen's answer, no.

Raul Sinha

The second one is on capital. On the call you mentioned how you still have quite a buffer to the 12% lower end of your threshold, but – and I'm not sure we should be doing this – but if you try to take a fully loaded view of the buffers that come in, including the counter-cyclical buffer as it gets ratcheted up over the next 18 months, both in Hong Kong and the UK, that room to the minimum 12 starts to erode away.

Iain Mackay

That's an interesting idea, of ramping up the counter-cyclical buffer over the next couple of years. The theory of the case behind the counter-cyclical buffer would be to be counter-cyclical, so the rationale of the PRA moving that up, earlier this year, is the notion that there is some point in the future where there's a higher level of economic stress, like with the experience by the banking sector in the UK as the UK economy responds to Brexit, and nobody knows what that really looks like now. It's all guesswork, but the analytics would suggest that there's more downside risk than upside risk to the UK leaving the European Union. Where that manifests, the notion behind the counter-cyclical buffer is that it would come off in those circumstances, as was done at the time of the referendum a year ago.

Going back to the basic mathematics, we sit just now with an ICG fully loaded of 11.4%, with the top end of our target range being 13%. For the last several quarters, we've said 12% to 13% is our range, but it's at the top end of our range, which we would expect as an appropriate place to operate based on the cycle which we're in right now, where we sit from a regulatory perspective. And notwithstanding the assertion by some that any ICG and Pillar 2A requirement is going in one direction, our experience this year – although I'm prohibited from going into the details by the PRA, our experience from this year is we can actually move it in both directions, across different

components and different dimensions of risk assessed through Pillar 2A. I think that comes down to us as an institution's ability to continue to refine and become much more adept and nimble with respect to capital management around the Group.

The progress that we've made as a business over the last 18-24 months in this regard fills me with confidence that we can continue to make progress in further fine-tuning; responding to regulatory requirements; being able to move through providing evidence of what we do from a capital management perspective; how we respond in stress; how well we're set up from a recovery and resolution perspective; how robust our capital management, but also our liquidity risk management framework is, is that we're able to, through the ICG and SREP processes, influence the outcomes from a Pillar 2A and 2B perspective as well. But it takes a little bit of time to move everybody in the same direction on that one.

So our view right now is based on what we see in front of us from a regulatory perspective. There's no reason why we should change our target range from a common equity tier 1 perspective. We've got a robust management buffer between where our ICG sits and the top end of our range, and an even more robust buffer about where we actually sit in common equity tier 1, at 14.6%. The fact that we moved from 14.7 to 14.6 is a good thing. I wouldn't have been happy had we not been generating capital net of scrip and dividends in the third quarter, but we were. We generated nearly $1 billion of capital net of scrip and dividends in the third quarter, and provided that's the dynamic that we continue to demonstrate, then I think we're in pretty much the right place, and that view is shared by my colleagues on the Group Management Board. So I do not see the need – and as a team, we don't see the need – at all, based on the current regulatory construct, to change the target range of capital requirements for the group.

Raul Sinha

Thank you.

Tom Rayner, Exane BNP Paribas

Could I start with pretty much the same question I asked yesterday, Stuart answered, because I'd like to push you on it as well; on this idea about the jaws into next year. I'm assuming you agree with this – it sounds as if the gross savings that you can make from here will be enough to offset underlying inflation, possibly any residual CTA costs. I know it's all going above the line, which leaves the investment and any performance-related as the driver of cost growth into next year, and I'm trying to set a sense – you did mention, I think, on the call that the investment in the second half wouldn't really lead to any big productivity gains, and my sense is that there will be a similar sort of annualised level of investment next year as well. Is that the same message for any future investment, that the productivity benefits of that investment might be quite limited? I'm trying to get a sense of what your message is on guidance.

Iain Mackay

If I gave the impression at all yesterday that the investment would not improve the productivity of the business, then I misspoke. I don't think I said that.

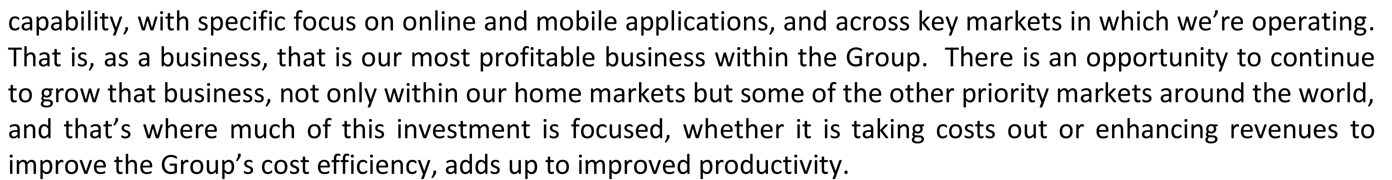
Tom Rayner

It might be my mistake.

Iain Mackay

But any investment we make has an ROE requirement against it, and if that is not at least in line with our hurdle, which would mathematically connote productivity, then unless it sits squarely into the regulatory and compliance space – i.e. mandatory – then those investments are not being prioritised. The focus of investment is to improve the ability to serve the customer efficiently, and the mandatory, in a compliant, well-regulated manner.

The investment the business has focused with a priority around retail – a number of the platforms are businesses within Retail Banking and Wealth Management – has been around further enhancements to the platform, digital



capability, with specific focus on online and mobile applications, and across key markets in which we're operating. That is, as a business, that is our most profitable business within the Group. There is an opportunity to continue to grow that business, not only within our home markets but some of the other priority markets around the world, and that's where much of this investment is focused, whether it is taking costs out or enhancing revenues to improve the Group's cost efficiency, adds up to improved productivity.

We are focused on exiting 2017 with our run rate in the range – like we talked yesterday – at 7.3 billion. That excludes the bank levy - assuming the budget doesn't change that - but that's supposed to phase down to a UK balance sheet only by 2021, but between now and 2021, that broadly speaking sits around $800 million or $900 million of cost for us each year. The focus remains, through the planning cycle and execution, on being able to neutralise the impact of inflation of our businesses through continuing to generate cost savings, and the desire is to generate productivity that supports some level of investment.

What we clearly see coming from our businesses is an appetite for investment into markets where we see the opportunity for growth and improved profitability being somewhat ahead of the business's ability to offset two things: inflation, plus the ability to invest. But when we can invest into improved profitability, into growing markets – which clearly continues to stimulate revenue growth – then we would prioritise those investments.

So what does that translate into, broadly speaking, for 2018, is we'll exit the year with a 7.3 billion run rate. We'll have carried over savings from work we've done in 2017 into 2018, which is largely reflected in that exit rate of 7.3. We would expect during 2018 to generate savings that largely offset the impact of inflation, and then to the extent that we've got an investment appetite beyond that which is currently planned, provided it leads to accretion from a returns perspective, then we'll support that. Right now, the investment decisions we've taken in the late first half and into the second half of the year has identified an opportunity to invest around $400 million into further growth of the businesses.

Will that be the case year in, year out? No, but it would be fair to say that the investment appetite from the businesses exceeds, overall, our capacity to support that and at this point, we have current capacity. So we'd expand that capacity, provided we see the returns coming from it, we would do so, so there's 7.3 billion, offset inflation, plus whatever investment is merited from a returns perspective, and if that's two times the 400 million that we're investing in the second half of the year at an annualised rate, it's not bad guidance, based on the conditions we're looking at right now.

Tom Rayner

That is good guidance, but I'd also now ask: is it not possible to meet that guidance without meeting your positive jaws? There might be enough investment opportunities next year with the right return profile, which means it's worthwhile investing more aggressively, even if that means cost growth exceeds revenue growth. Stuart kind of half-heartedly, I thought, came back and said, 'We are still going for positive jaws next year'. I'm just testing you to see how strong that commitment is, given your other comments.

Iain Mackay

More fulsomely, we are still going for positive jaws next year. But what we'd like to convey is that expanding jaws to the point of adversely impacting our ability to invest into growth opportunity in the business is not what we're about. So from our perspective, if we generate two points of positive jaws, in a growth environment that would suggest 3% to 4% revenue growth opportunity in the markets we'd like to grow into because we think there's a profitable growth opportunity, then generating one to two points of positive jaws would be a good place to be.

How wide jaws goes will be informed by where interest rate is, our ability to generate strong revenues off that and the ability to price on both the asset and the liabilities side. We think keeping jaws positive, but reasonably narrow, is a pretty sensible planning assumption for the moment; but with returns still under our starting threshold of 10%, we don't think that it is appropriate to have costs expand at a rate faster than we can grow revenues. Not on a quarter by quarter basis – there's always going to be potentially a bit of a mismatch between the spend, the investment, and how the revenues flow through – but as Stuart said yesterday, on a calendar year

basis, our objective will be continue to generate positive jaws and continue to improve the overall cost efficiency and operating efficiency of the Group.

Claire Kane, Credit Suisse

A couple of questions on capital, please. Given more investment spend, and now we've only got, I think, around $20 billion of initiatives left to come through on RWAs, which is broadly what you did in book growth in one quarter, we'll start to see more capital generation to come down from what it's been in previous years, and you could get to the position where you're paying out all of that capital generation. My question is - are you comfortable paying out 100% of capital generation, given where your capital levels are? The second one is on the capital position of HBAP. Arguably, the BoCom benefit you got at the Group level has been absorbed by this 40 bps Pillar 2A add-on, and I wondered if you could comment on when we'll see some of the excess capital in Asia upstreamed to the Group; what that minimum requirement is, because if we don't get that capital ratio down, then the Group one won't come down either.

Iain Mackay

From the surplus capital perspective, Asia's not a problem. We've got one or two locations within the HBAP portfolio where there are local regulatory requirements that presently, given the legal entity structure of the HSBC business in that jurisdiction, makes it a little bit more difficult to get capital out, so what we're looking at is how we better structure our business in those locations to use that capital profitably within those jurisdictions – i.e. generating income from the capital that is required to be there, either by booking more profitable business through that legal entity or organically growing the business in that legal entity. And that issue exists in two markets where there is absolutely the propensity to grow profitability.

The alternatives also being considered are about how can we structurally get capital out and return it to the parent. We can either return it through a capital restructuring, or through dividends paid by those operating entities, up through HBAP and then onto the holding company. If you look at Hong Kong, what Peter and Kathleen and the team have done over the last 18 months is work very closely with regulators to ensure we're not carrying buffers over and above that which are informed by regulation, and what we think is appropriate as a management buffer in the context of the Asian operations.

In terms of the benefit we got from BoCom, we got 110 basis points of benefit in our common equity tier 1 ratio from the change. It had no impact in Asia, because that's exactly how BoCom was already accounted for from a regulatory perspective within HBAP, so net-net there was no benefit to the regulatory capital construct of HBAP. That was a regulatory capital construct benefit to the holding company, because the regulatory requirement applied by the PRA was different to that applied by the HKMA; we convinced the PRA that the application being applied by the HKMA was the appropriate one, with which they agreed.

What is important is that capital comes from generation of profit, and the focus of our energy is on those legal entities in which capital is controlled, and improving the profitability of those entities that are not paying an appropriate dividend – or any dividend, for that matter – up to the holding company. When you look at the dividend payout ratios from HBAP, they are more than adequately compensating the Group for the capital that we've made available to them, and their ability to continue to generate that capital and upstream it to the parent company is not a concern I have in the current operating conditions.

You know exactly the legal entities that I'm talking about. We've got to improve the profitability of the US, and we've got to improve the profitability of some of our continental European operations and their ability to upstream capital to the parent company. There are one or two locations in Asia where we need to improve that – Indonesia's one – and you can see from the data we provide, Mexico's very much moving in the right direction, in line with the strategic actions that we talked about. They're going to hit our targets for this year; the US is not, so we need more work to do in the US.

But the compensating factor, at least for a period of a couple of years, is through continuing to be successful in CCAR, hopefully through that success getting no objections to our capital plans from the Federal Reserve, is that we'll be able to continue to upstream the surplus capital that sits in the US entity on the back of disposing of the

credit card business, the upstate branches, running down the sub-prime portfolios. That's where the real capital surplus actions are for us presently, but the important part here is the balance from a capital management perspective is getting those entities which are not generating sufficient profits to the position of generating profits, and through success in local regulatory stress-testing, CCAR and varieties of the same around the world, getting no objection to capital plans – to upstream that capital to the Group.

There are two elements to this. It's the capital generation of the operating subsidiaries and the ability to upstream, and then, in the less than half a dozen cases where we've got surplus capital requirements sitting in the legal entity, for whatever reason, it's working with the local management teams to get that out and back up to the parent company. That's it, and that capital generation supports growth.

Claire Kane

I agree with what you've said. My point on BoCom was, like you said, it didn't affect Asia, but you haven't chosen to upstream that excess capital in HBAP yet to the Group, so the Group –

Iain Mackay

There was no excess capital relating to BoCom in HBAP.

Claire Kane

But in that subsidiary, there is excess relative to a 13%, so if there is no excess there because local requirements are not allowing you to upstream that capital, then arguably, there isn't really much at the Group level either because your surplus in the US –

Iain Mackay

Kathleen the payout ratio of HBAP is about 60%, right?

Kathleen Gan

Yes, that's right.

Iain Mackay

We're upstreaming 60% of our profits from HBAP, and we meet, with a small management buffer, the regulatory capital requirements of HKMA. Within HBAP, there are subsidiaries which we can, and are, doing work on, but it is a relatively small amount of capital surplus to local regulatory requirements.

Claire Kane

Would you be, at a group level, comfortable having a stable CET1 ratio going forward, allowing the growth to absorb any capital generation you make –?

Iain Mackay

Absolutely. The dynamic of a 12% to 13% capital ratio is that we are generating profits that are upstreamed, that support dividends. So to go to your answer – would I be happy paying out at 100% for a prolonged period of time? No, I wouldn't. The factor that influences why we're paying out at 100% right now is that we've got the better part of two billion plus coming out of our capital base for the last three years on the back of CTA. We cut off CTA at the end of 2017 - in 2018, our payout ratio goes back down into the mid to high seventies, and then we would expect it to progress down from there.

In the current growth environment, with strong capital generation – with the need to move our capital ratio closer to 13% than the opposite direction – then absolutely, I would rather do it through profit generation and investing for growth, and that's the dynamic that we'd manage through. Our focus is to maintain a dividend distribution of 51 cents per share. The payout ratio will be around 100%, and because of slightly improved profitability, the plan would have suggested it would have been slightly over 100% this year. We deliver a quarter in line with the business forecast. We're probably going to be at around 100% or slightly better than that from a payout ratio,

which is going to be a better than planned performance for the Group from a capital management perspective. And then, with the conclusion of CTA this year, which has been around two billion, give or take, over the last three years, that moves the payout ratio for the Group down to the mid to high seventies, and then we'd expect to progress further down from there. Okay?

Anil Agarwal, Morgan Stanley

I have a question on loan growth. If you look at Asia loan growth, it's running at about 17%. Hong Kong is up 20%, but if I look at the system averages in most of these geographies, with the exception of Hong Kong – Hong Kong is running at 16%, but on most of the other geographies, they're running in single digits; maybe 10%. So where are you gaining share? What kinds of loans are you giving?

Kathleen Gan

We've seen the balance sheet growing year-over-year in most of our countries, except for maybe Indonesia, for example, and part of that is we just integrated the branch and subsidiary together, and we are going through a phase of what I call settling down through the integration. But for most of the major countries, we've seen growth in the balance sheet from Asia.

Kathleen Gan

We've started to see trade picking up again this year; term lending in the corporate side, mortgages in particular in Hong Kong and China. And in India, we're starting to see some pick up in terms of lending, so it's quite broad. In Singapore we're starting to see more trade flows coming through as well, so it's all helping.

Iain Mackay

I think there's one other dynamic which is not a major feature, but we have a fairly strong US dollar denominated deposit base within Hong Kong, and where Hong Kong can appropriately be a booking centre for any of the branch business that is dollar denominated around Asia, then particularly in a banking and markets context, we've used the Hong Kong balance sheet, because that's where the resource sits, and because the entity – the country in which we're doing the business is a branch of the Hong Kong and Shanghai Banking Corp. There is some element of that growth that we've identified, which is Hong Kong being the booking centre for that branch-related activity in US dollar-based lending.

Kathleen Gan

Yes. China, for example, uses the strong balance sheet quite effectively for some of our customers.

Alastair Ryan, Bank of America

The jaws which you're going to deliver – so the cost/income ratio of which you're going to deliver positive jaws this year is –

Iain Mackay

What, you're asking me to fill in the blank there?

Alastair Ryan

Yes, please, just because there's a lot of CTAs and moving parts. And then the second one is - it really feels like the bank was shrinking for a long time, and so you had cost/income targets. Those weren't achievable. You moved to an absolute cost target, which was a low target with significant costs to achieve. It feels like you've pivoted now, because the bank's growing, and also you must have much better visibility on income than you've had for quite some time, because interest rates have risen. They may rise further; they may not, but they have risen. That will mechanically flow through after a period of time.

Trade is a relatively annuity business. Your loan book is a pretty annuity business. You demonstrated relatively low revenue volatility in GB&M over the last 18 months, except Q4 last year, but we won't mention that. But it feels like you're letting loose on costs because you've got the confidence, the incomes, there to support it, so

what we're missing is either a cost/income where you settle – it takes you back to a time when the bank was last growing, where you had a cost/income – or a rate of revenue growth, and I think that's what we're struggling to fill in the gaps, because we haven't got enough data points, which is probably deliberate.

Iain Mackay

So it's 57% year to date, and I think we end up around the 60% or 61% mark.

Alastair Ryan

So last year was 60%?

Iain Mackay

No, this year we're looking at around 60%.

Alastair Ryan

So the figure that you're targeting is ex-CTA, ex-levy, adjusted revenues.

Iain Mackay

Adjusted revenues, adjusted costs.

Alastair Ryan

What was the 2016 number off of which the jaws will be positive this year?

Iain Mackay

Sorry, I'm not following your question. You want to know the cost efficiency ratio from last year?

Alastair Ryan

Yeah, because you've committed to delivering positive jaws this year.

Iain Mackay

Yeah. So I think it was 61% last year, and we'll be around the 60% mark this year.

Alastair Ryan

Thank you.

Iain Mackay

Okay. So the notion – so do we use the cost efficiency ratio as a key driver of behaviour? No, because we've seen that drive slightly dysfunctional behaviour in the past. There's lots of things you can do to influence a cost efficiency ratio. The positive jaws goes back to the notion of affordability from a business. If you're generating 3% or 4% or better revenue growth, which we've seen a number of our businesses do, then your ability to afford a higher rate of investment is informed by that revenue growth, and over a period of time, by delivering positive jaws, you will progressively move the cost efficiency ratio of the firm back into the high 50s, and then hopefully, over a longer period of time, a little bit lower.

Now, that being said, I wouldn't for a second suggest that you look at the cost efficiency ratio of the Group in 2010, for example, and look at today and go, 'Well, we can aspire to that'. There are three billion of costs that exist today that did not exist in 2010, and that is the whole expansion of the financial crime risk management capability; stress testing; regulatory reporting that has gone absolutely through the roof; and a much wider regulatory compliance requirement, whether it's from a conduct perspective with the FCA in the United Kingdom, or their equivalent in different parts of the world. So the regulatory field in which we're playing bears no

resemblance to where it was when I started my job at the end of 2010; no resemblance whatsoever, and there's just shy of $3 billion more cost that did not exist.

That's not going away any time soon – do we believe, based on where we are from a technology deployment perspective, for example in financial crime risk management, that as we deploy fine-tuned models, improve the application of machine learning and AI, which is a huge part of tracking patterns within transaction monitoring, will allow us to become more efficient and take a lot of what's being done manually now, progressively out of the process? Yes. Does that mean we might go from the better part of a billion - $900 million a year – spend on financial crime risk management to 750, 800 over the course of the next couple of years? Yes. Does it mean we'll go from 900 to 400? Never.

So there are absolutely productivity opportunities across our global businesses, the control functions, as we deploy improvements in process; technology that enables that. But there is an absolute cost shift, so to get to a cost efficiency ratio for the Group that's back where we were in 2010, for example, I think, in anything that I can envisage right now, is impossible. Now, if you really go big from what you could do with big data, artificial intelligence, machine learning – which we are deploying across some fairly mundane applications within finance, through risk management, financial crime risk management, customer analytics, and we will continue to do more and become better at this – yes, you can really – particularly in Andy's area in operations, you can – he's already taken massive costs out. You can see much more coming out.

It's still pretty difficult to see getting back to a cost efficiency ratio in the low 50s for a bank operating internationally, with the network that we've got, but at lower cost efficiency ratios, the profitability that you start to generate is pretty good stuff. It's certainly above the 10% return on equity that we've talked about, but we've got to get the 10% first, and that's what's going to keep us informed around positive jaws.

Alastair Ryan

You've slightly completely managed to dodge the invitation to talk about revenue growth, and your confidence in the outlook.

Iain Mackay

Well, not intentionally. Sorry, I just got carried away in the cost equation – what we're seeing, and I think some of Kathleen's comments go to this, are one or two markets in Asia which I think structurally are presenting some challenge; not just for ourselves, but others. Indonesia's probably the stand-out in that regard in Asia. But when you look at Hong Kong, mainland China – specifically within mainland China, good organic build within Pearl River Delta, whether it's retail bank – the securities company, Qianhai Securities – is it going to generate massive profits in 2018? No, but it will start to build revenues and build share and take a bigger role in capital markets modernisation in China. That's certainly the intention, the aspiration, and we believe in our ability to do so.

You then look at India, Singapore, Malaysia, Australia, then some of the lesser markets – around Vietnam, for example. Each of these businesses are growing its balance sheet. They're growing revenues off that. They're all subject to different interest rate environments. They're not all dollar-denominated; they're very, very different, so you can see that coming though BSM and the businesses, but that opportunity is clearly there. We're looking at a healthier Europe. You saw the confidence data coming out this morning. It hasn't been at that level since 2001, and ironically, Brexit possibly presents a really interesting opportunity for HSBC to concentrate more of its business within a universal bank sitting in continental Europe, and therefore competing, conceivably, much more effectively and aggressively with some continental European banks for domestic business as well as the international business, which we're very good at competing for.

The US, I've talked about. The business is building. We will have a break-even business in Retail this year. We'll have improved the profitability in Commercial Banking and Global Banking & Markets, but we have clearly a lot more to do, both on revenue generation and cost management, within the US business, but the team is very focused on it. We've got great rebuild going on in Mexico, very much within risk appetite, building confidence around what the team's doing there. I think we've got an absolutely cracking team in Mexico, led by Nuno, and Canada is showing all the right signs of moving in the right direction.

So informed, 1) by economic conditions; 2) rate environment almost certainly involved by those economic conditions; 3) the actions that we've taken over the last couple of years to improve our ability to compete and our efficiency in competing in those markets, there is better confidence coming through the global businesses around their ability to grow revenues. And that is part of what informs Stuart's willingness to sit down with John Flint and say, 'John, right, we've taken gains out of Visa . I don't want to hold back your propensity to invest, so let's go ahead and do it, and then we'll sit down and explain to the investor community about why we think that was the right thing to do.'

Richard O'Connor

You see the balance sheet starting to move through the gears, loans grown faster than deposits. The deposit surplus is slowly moving – the loan to deposit ratio is slowly moving up. We've got to keep that up. We won't do it every quarter. There's good momentum in the balance sheet, and if we get interest rate rises, deposit revenues start to kick in as well as we go into 18/19, so good opportunities there.

Iain Mackay

Going back to Claire's question, you're right: we've got a bucket of stuff on RWA initiatives, principally in the model approvals area with the PRA, where we're probably not going to get those numbers this year. We'll get them, we hope. We have good confidence around the quality of the models, but we're probably not going to get it this year; we'll get it next year.

But beyond that, as Robin Phillips and Matthew Westerman continue to drive that capital allocation discipline through customer relationships that demonstrate value to HSBC – we are not a charitable organisation. We love supporting our customers around the world, but there's got to be value in that relationship for us, and Robin and Matthew are very much moving that, and as they continue to move it, we continue to liberate capital for investment in other relationships that are profitable, or frankly – and this is where it becomes challenging for us – it strengthens the capital ratio, which is great to have, but I'd like to be able to deploy it somehow.

It's equally true in CMB. Noel and the team have a massive customer base across the network that we offer, and his team has, and is spending in 2017, quite a lot of their time making sure that we've done back book remediation: in as crude as possible terms, customer due diligence for customers that have been with us for years from a financial crime risk management perspective, and making sure that we've got files that are absolutely up to date; we understand what our customers are doing. And the best and most efficient way that we've found to do that is having the customer relationships at the front end, interacting with customers to do it, and while they remediate that back book, as you can imagine, there is some distraction to building new business.

Notwithstanding that, you can see what Noel's teams have done around the world. They've grown their balance sheet; they've grown revenues, and they're delivering and improving returns within the business. I think Noel's view certainly is – and it's shared by the rest of the team – is that as we move into '18 and beyond, having that team, yes, embedding CDD as part of managing the customer relationship allows us to focus much more on how we build business with those customers.

Manus Costello, Autonomous Research

I have a couple of questions. Firstly, on your IFRS 9 guidance. You talk about a $2 billion increase in allowances and less than 15 bps of impact on the core Tier 1 ratio. If I just try and square that, does that mean that there's not much offset in the expected loss deduction, that you'll still be carrying quite a big expected loss deduction? Because very little of it seems to be absorbed by the expected loss deduction. I would have thought that it might have been. And my second question was actually just following up on that RWA point. If I look at underlying rate of growth of RWAs outside of model approvals from balance growth, it's in the mid to high single digits. Is that what we should expect going forwards? I'm just trying to piece it together. You've got some more model approvals to come. We obviously know that you've exceeded your RWA targets. What is the underlying RWA growth rate we should be mentioning?

Iain Mackay

I'll let Gavin take the answer on the IFRS 9 point around excess EL. The answer to the RWA question is going to be informed by mix, because there are different RWA densities by product type and by jurisdiction. So where we grow more in certain jurisdictions, because of local regulation there's a higher RWA density in some versus others. So there's absolutely a risk component in there. Optimising around PRA RWAs is a great starting point from a capital efficiency perspective. But to really get at any real or perceived surpluses within local jurisdictions, you have to optimise around local RWAs. And there are very few markets where local RWAs are calculated identically the same. There are high degrees of similarities, but there are also a few markets where the differences are quite significant.

Increasingly our teams are very focused on local RWA optimisation. That translates into meeting local regulatory requirements. That's got the propensity, conceivably, to identify surpluses against local RWA requirements, which we could make the case for either deploying into the businesses more aggressively or upstreaming to the parent company. But I think in the round if we're looking at a balance sheet that's growing in the mid-single digits, with the right mix and continued focus and optimisation around local RWAs, then the rate of growth within RWAs, from a credit perspective at least, will probably be broadly in line, and, ideally, slightly slower than the rate of growth of the balance sheet in nominal terms.

Manus Costello

Just to square that with the dividend guidance, because you're talking about a payout ratio in the 70s, you're therefore talking about sort of 5% balance sheet growth, 3 or 4% RWA growth, and the rest gets paid out.

Iain Mackay

Well, possibly, but hopefully redeployed into capital growth, which is the opportunity to accelerate and later pay its growth beyond that rate.

Richard O'Connor

Looking at the last three quarters, the RWA efficiency, i.e. loan growth v RWA growth, it's been about 3 or 4%. We can't keep that up forever. But assume we keep that up, although not every quarter, and then that declines over time. I think that's the best way to think about it.

Iain Mackay

There is a point at which we'll reach optimisation around RWA management, whether by local regulatory or by PRA requirements. And exactly to Richard's point, at that point growth is going to translate into higher RWAs. And assuming a reasonably consistent mix, then the rate of growth within RWAs will be consistent with the rate of growth in the balance sheet.

Gavin Francis

The answer to the question is excess EL does give some protection from a capital perspective, and indeed that's part of the calculation, but we would continue to have excess EL protection going forward, should there be increase in impairment allowances in the IRB space. We utilise it, but there's still more there.

Richard O'Connor

And assume a 25% tax rate on that.

Iain Mackay

Yes.

Andrew Coombs, Citi

If I can ask three follow-ups on the investment spend. The first one, if we go back to the – which feels like a long time ago, but the Investor Day 2015. Within that cost walk you had $1.5 billion investment embedded in for Asian loan growth. You had digital spend, $1 billion captured in your CTA. And actually the gross cost saves have been

higher than you anticipated back then, which has given you more flexibility on investments.

Iain Mackay

We spent more to realise those savings than we talked about back in 2015.

Andrew Coombs

If we think about where we are today, you've clearly identified these additional opportunities for investment, the 0.4 billion in the second half. You've talked about, primarily, RBWM but I'd love just a bit more granular detail about exactly where those investment opportunities are, above and beyond what you previously identified. That would be the first one.

Iain Mackay

It is pretty much across the board. We've talked about RBWM because that represents incremental investment, quite rightly as you describe over what we talked about in 2015. But the level of investment that we've put in to Commercial Banking, Global Banking and Markets – Global Banking and Markets as an example – within the FX platforms, so much more is being automated from an FX standpoint now, in terms of fulfilment from a customer standpoint. In the Equities business, in key markets, principally the UK, Hong Kong in terms of building our capabilities to support a broad range of equities products, and again you see the benefit of some of that coming through with numbers in the third quarter, with a very strong performance supporting in the prime brokerage area.

Within Commercial Banking the investment over the last couple of years will continue into the next couple of years around modernising the Global Trade and Receivables Finance platforms. There is we think a very significant opportunity there, whether it's leveraging blockchain technology, building standards around the industry around documentation that supports trade. You can already see the benefits coming through Global Liquidity and Cash Management, where we've invested, and will continue to invest, and the technology and process supporting that.

So it is – the $6 billion plus of spend we've done over the last three years has been distributed across the businesses and the functions in areas where there's been a business case that backs it up. We don't generate revenues from the functions - it's really about how you create greater efficiency to support the business model, the compliance requirements within the organisation. Within the businesses, it's been focused on operational efficiency, but it's also been focused on how that operational efficiency translates into our ability to better compete, expanding the product range, the technology that supports that product range.

So the incremental spend we've talked about has largely been focused on Retail Banking and Wealth Management. That $6 billion plus we've invested over the last three years has been across the range of opportunities, which on a payback ROI/ROE perspective has made sense for us to do.

Andrew Coombs

The second question is you've linked the additional investment, in the second half, to the Visa gains. Is it a case of you look to do something similar going forward, so if any other gains were to materialise you would do something similar, or is it very much case by case basis?

Iain Mackay

That was a bit of a one-off. It doesn't mean there won't be one-offs. But it comes back to Tom and Alistair's question, is that it's going to be informed by our capacity to afford through the jaws.

Andrew Coombs

Which leads me to my final question where you talked about every decision has to be ROE accretive. Is it ROE accretive in year one, year two? When does that have to materialise?

Iain Mackay

Our preference is year one, because from a planning perspective – I've been around this block far too many times,

whether it's been at HSBC or other employers, where you get fantastic business cases put in front of you where you've fabulous accretion in year three, year four and year five, and it never shows up. We've put a lot of pressure on our teams is to make the case for short cycle payback. It doesn't mean we ignore cases that go further beyond, because I think that would be short sighted. But we're really challenging the teams is make the case. You can't invest for three years and have nothing to show for it. It just doesn't make sense.

Gurpreet Singh

Maybe for Kathleen on HIBOR. The jump, quite volatile. Can you talk to us on what is causing the tightness. Can HSBC benefit from it in the first quarter?

Kathleen Gan

Based on what we've seen previously, I think that, yes, HIBOR has jumped around a little bit recently, but, yes, it's seeing how it's going to sustain in the outer periods. But if HIBOR does go up then we will definitely benefit on the big Hong Kong deposit base that we have. So we would like HIBOR to go up as well.

Gurpreet Singh

Any sensitivities?

Kathleen Gan

I think the sensitivity is what we disclosed previously, and I think there is actually a slide – page 12 on the investment side as well. You can see that the Hong Kong block, I think it's about $500 million.

Participant

Kathleen, a follow-up question is when you decide to raise the prime and savings rate will that benefit start to reverse?

Kathleen Gan

It depends on also what the pass through assumptions that we're going to have with our customers.

Rohith Chandra-Rajan, Barclays Capital

A couple, please. Coming back to the mortgage pricing in the UK, when you think about return on risk weighted assets, what risk weighting do you think about? Because if it's the current 5 to 6% then that could be extraordinarily profitable. The PRA, future requirements, less so, and maybe output floors different again. So just wondering how you assess that. So that'd be the first one, please.

Iain Mackay

So at this point in time there is no indication coming from our regulators that there'd be a specific floor applied to HSBC from a mortgage lending perspective, whether it comes through a wider range of regulatory change, whether it relates to Basel III revisions or the like. We have not incorporated in planning assumptions, because there simply isn't enough information to inform a sensible planning decision around that. If you reflect from a safety and soundness perspective, you put yourself in our regulator's shoes, and you look at the output of the stress tests over the last couple of years – we'll get stress test results later in November, which hopefully don't reveal anything particularly new or different for us, based on prior years' experience – is that under significant stress in the UK market, our mortgage portfolio has a drawdown which is small compared to that of our competitors.

If there is a practical application, which one would like to think informs supervisory and regulatory decision making, it is in actual fact the stress test. I would like to think that that is what informs why I think the PRA look at our IRBA models for our mortgages in the UK and think it's an appropriately constructed, well managed portfolio.

Richard O'Connor

Even where it's fixed rate business, it's mainly two years so these things don't come in until 2021 or beyond, so

there'll be times we price if the market would bear it at the time.

Rohith Chandra-Rajan

So you'd be happy to price off a 5 to 6% risk weighting.

Iain Mackay

If that's the risk weighting we've got. If the risk weighting we end up is 15% then that would clearly be part of the pricing consideration.

Richard O'Connor

We used the pricing in Hong Kong of 15% or 25% on new. It's not something we're not used to.

Iain Mackay

Absolutely. Those floors have been in place in Hong Kong now for some time, have increased. Part of what the businesses have to do in terms of pricing dynamically within the market. Certainly what we've seen in Hong Kong is that when a rule applies to one it applies to all, so it keeps the playing field level.

Rohith Chandra-Rajan

And then briefly on Europe volumes. Commercial lending pales in comparison to what you're doing in Asia, but actually the incremental growth is pretty fast. That contrasts with what we're seeing elsewhere where things like credit conditions survey, and other banks are telling us that there's limited borrowing appetite from customers. You guys are growing quite quickly. What do you attribute that to?

Iain Mackay

There's an aspect of mix within the customer base, which is quite important. Particularly if you look at Commercial Banking, it equally applies to the large global markets. We've got a large mix within Global Banking and Markets, which is a corporate customer base, as opposed to financial institutions base. Commercial Banking covers a broad sweep of small, medium and large corporates, a not insignificant proportion of which is focused on export trade. When you look at sterling sitting where it is, and has been since the Brexit referendum, where customers have the capacity to monetise the benefits of weaker sterling then we've seen some move in that direction. I think equally, just to balance that equation out, talking with Ian Stuart and with Noel, you do see probably just a little more cautiousness, contemplation around big investment decisions. But in terms of supporting working capital requirements, Global Liquidity and Cash Management, Global Trade and Receivables Finance, some term lending, you're seeing a reasonably stable, consistent business appetite within our customer base. And that is again maintaining a very, very consistent and prudent risk appetite across that customer base.

Can I attribute anything specifically, sector by sector? No. But I think part of it is that we've got a larger proportion of customers within the customer base that's got an international orientation, and are looking at strength in continental Europe and further afield, where their customers sit, where you've got upticks in demand, that our customers are benefiting from.

Richard O'Connor

Very strong trade finance market shares in UK, Hong Kong, Singapore, with 2 to 4% growth in share year on year in those three jurisdictions, for example.

Iain Mackay

The other aspect is that we all sit down on a regular basis and say, 'How do we demonstrate the value of the HSBC network from a shareholder's perspective?' And that's one manifestation of it is the fact that we can support customers across multiple jurisdictions across the most important trade corridors in the world. You almost see it relative to domestic competition when the international competitive environment changes. And clearly the devaluation of sterling created an interesting competitive dynamic for export orientated businesses in the UK. Would we see that without the strength and expanse of the network across which we serve? You could make the

argument we may see it, but we'd probably see less of it.

Martin Leitgeb, Goldman Sachs

Two questions, please. The first one just to follow up on the UK. I was wondering if you could share what your average cost of deposits is within the UK ring fence, in the future structure. I don't think you disclose. I think ballpark I think I got to a level of 30 basis points or lower. Is that the right number to think of? And the second question, more broadly on the allocation of indirect costs or overheads, is there any general key on how you allocate those costs across businesses, across jurisdictions, or is this essentially – take, for example, Retail. Retail accounts for roughly 40/42% of Group costs. Is it fair to assume also, in terms of overheads, you have a similar split?

Iain Mackay

No, there's an allocation key. So where costs can be directly attributed to a business, they are attributed to a business, regardless of where they sit in a Group function. Headquarters, generally speaking, cannot be directly attributed to a business, with a few exceptions. But where it sits within host or any of the Group functions, the allocation has got a key attached to it, which is logical related to activity that those businesses use from those functions.

My guess is that you might be driving after why does Europe look like the way Europe does? The reason for that is headquarters sits in Europe, and there are certain costs that sit in headquarters that are not allocated out to the businesses, so from a geographic perspective that tends to cloud the picture within Europe.

Richard O'Connor

When you look at countries like the US, about half the overhead is paid by RBWM. So when we're talking about Retail breakeven it doesn't – we pay half the overhead costs in places like France and the United States for example.

Iain Mackay

On the costs for UK deposits, I do not have that at my fingertips.

Richard O'Connor

Assume what it is currently.

Iain Mackay

The structural change does not change the cost.

Richard O'Connor

It's primarily current accounts, as you know,1 basis point in current accounts at the moment, and a bit of savings account on top, so the number you've quoted is about right.

Joe Dickerson, Jefferies & Company

Just a couple of questions. Firstly, you've been gaining market share in European Rates and Credit, and I'm wondering if you could provide some colour as to how you've been doing that, and if it's a trend that we should expect to continue into next year – your results, particularly relative to peers were quite strong in those two categories. And then, secondly, can you give us a sense of how much costs are associated with the DPA in the US, and if you expect that to end as planned this year?

Iain Mackay

So the Rates and Credit story is about sustaining a capability as others are withdrawing. Our Rates and Credit platform is basically of the same platform from which we manage Balance Sheet Management. We do Balance Sheet Management by country - we manage liquidity on a jurisdiction by jurisdiction basis. We require each jurisdiction, broadly speaking, to be self-sufficient from a liquidity and liquidity risk management perspective, and

therefore the management buffers. And therefore that liquidity surpluses are managed in each jurisdiction.

The platform, and the skill set, for trading Rates and Credit, is very little different to the platform that we have deployed consistently globally for the management of our own surpluses. Because the marginal cost to us of maintaining a Rates trader and Credit trader within some very small jurisdictions, whether they're in Europe or further afield, is literally that: very marginal. We have maintained the capability to trade Rates and Credit in the vast majority of jurisdictions in which we operate, whereas others have backed out.

Richard O'Connor

Also, making sure we get our fair share. We're very big lenders and provide cash management to our corporates. People like Matthew Westerman and team are making sure that we get our fair share of other bits of business as well.

Iain Mackay

Costs associated with the DPA sit, broadly speaking, within Financial Crime Risk Management. There is a single element of that cost, which is the cost of supporting our monitor. There is an independent monitor appointed as part of the DPA. That monitor started his work six months later than the DPA started, so he started his work in July 2013. And it will therefore run – if the DPA is lifted in December, regardless, the monitor will run through to July 2018. Those costs will remain until the monitor leaves. When the monitor leaves, the costs associated with that will drop away. The annual costs for the monitor runs somewhere between US $120-150 million. That would be a one-time saving that we would realise when compared to the last five years.

Costs more broadly relating to the consequences of the DPA sit within that Financial Crime Risk Management bucket, of broadly speaking $800-900 million per annum. And as I mentioned earlier, we would expect, over time, to realise some productivity through the deployment of AI, machine learning and the technology platform, particularly in the transaction monitoring, which is incredibly intensive, to realise some economies. But the key component of cost, which would drop away with a satisfactory resolution of the DPA at the end of this year, would be the monitor's cost.

Joe Dickerson

And do you expect a satisfactory resolution at the end of this year?

Iain Mackay

That is a decision that rests entirely with the Department of Justice. We are very much of the view that we have met all of the obligations under the agreement. We have demonstrated that not only have we been but we will remain committed to ensuring that we've got very robust financial crime risk management capability. There are things that we do now which, frankly, are well ahead of the industry in terms of capability to conduct investigations, pick up specific trends, co-operate with law enforcement agencies around the world. So we've demonstrated clear commitment to that. And that's what we've demonstrated, and will continue to demonstrate, and will continue to refine.

Notwithstanding that, we'd also be the first to acknowledge that there are more things that we need to do. And the decision that the DPA needs to make, and that sits entirely with them, is around, I suspect, their evaluation as to not only have we fulfilled our obligations but do they believe we're far enough down the path in terms of what we openly and happily recognise are things that we can continue to improve on.

Magdalena Stoklosa, Morgan Stanley

I've got two. One is a follow up. We've talked about your delivery of performance within Global Banking and Markets, but could you help us think about the outlook and particularly – Markets is anybody's guess, but within more of your cash liquidity and trade finance businesses that you've mentioned from the perspective of better market shares and so forth, because I suppose what interests me is the growth, the pipeline, what sort of competition are you facing. You've mentioned Asia. I would assume that you face local competition and global competition in those markets as well – any sense of how we should think about it. And my second question is very

short. Regarding scrip dividend going forward, is that something that you may rethink as an option?

Iain Mackay

The second one is easy. We are rethinking it all the time, but there are shareholder constituencies that have very different views of scrip. We have some who think it's fabulous. They love it. They use it. And we've got others, broadly speaking the institutional investor group – and even within the institutional investor group we've got different points of view around it. In certain circumstances it is one very useful capital management tool. In the circumstances in which we found ourselves presently it is frankly a bit of a pain because it contributes to dilution in the shareholder base, which frankly we would rather find ways to mitigate. One way to mitigate it would be to either suspend the scrip or cancel the programme completely. That would run into different points of view from different not insignificant cohorts of shareholders within the group.

When you then think about alternatives to it, whether for a dividend reinvestment programme for example, that is widely recognised within the UK market. There's lots of companies that run a dividend reinvestment programme. It doesn't exist within the Hong Kong market and the ability to deliver one within the rules within Hong Kong – nobody's succeeded. I think Pru tried a few years ago and had to bail out on it. But it would be fair to saying looking at it from a group treasury management perspective, from a strategic perspective we'd revisit the alternatives. I've got lots of your colleagues on the investment banking front, as well as many of your colleagues around this room, that show up in my office on average once a quarter with a new idea around scrip. We have yet to come up with one that really works.

On the outlook around Global Banking, what I can say is looking at the banking products – Global Liquidity and Cash Management, Global Trade and Receivables Finance, Securities Services – good pipeline. What Robin and the Matthew and the teams do is very focused on building the pipeline. There is an element of volatility, whether it is DCM, ECM around the timing of the year. We tend to see first and second quarters heavier. The second half of the year tends to calm down as the large corporates in our portfolio tend to start refocusing on next year and those capital actions they would take in the first and second quarter of the year. The one exception is the third and fourth quarters of last year which were stronger than the first and second, but that is largely attributable to peculiarities with the first and second as opposed to necessarily something odd in the third or fourth.

On the Rates, Credit and Foreign Exchange businesses, I wouldn't even attempt to forecast it. I think what is clear is that in Rates and Credit, as Joe pointed out, we are picking up market share, but even within that improved market share there's volatility that's coming through that. The most competitive space that we all compete in right now is FX. There is a lot of business in FX going directly through – it's cutting out the banking from – certainly from a small business and a retail perspective. It's an automatic settlement programme. Platforms that obviously touch the banking sector at some point, but we're picking up less revenue share.

What Samir and the team have been very good at is early recognition of those trends and where we believe we have a product that competes effectively; it is then investing into that space and improving our execution. And sitting within the corporate offering on HSBC there is a FX automated offering there, where corporates of all sizes within the HSBC portfolios can transact at best rates foreign exchange much more efficiently and at lower cost now than they could even two years ago. Volatile space and very difficult to predict the revenue trends within it. Within Equities, Global Banking building pipelines is largely what the team is about.

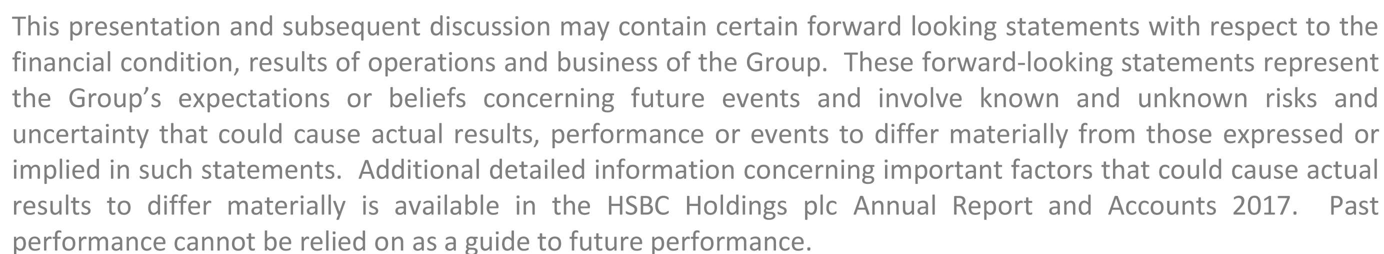
Richard O'Connor

Broadly we said for GB&M mid-single-digit revenue growth 6% year on year, so there or thereabouts. Cash in particular, our balances were up 7%, so we are in that ballpark. We continue to take a bit of market share, quarter by quarter.

Iain Mackay

Okay. Thanks everybody.

Forward-looking statements



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