Transcript

Full-Year Results 2017
Conference Call with Analysts and Investors
hosted by Stuart Gulliver, Group Chief Executive, Iain Mackay, Group Finance Director and John Flint, Group Chief Executive Designate

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Stuart Gulliver, Group Chief Executive

Good afternoon from Hong Kong, good morning in London and welcome to the 2017 HSBC annual results call. With me today are Iain Mackay, Group Finance Director, and John Flint, who takes over tomorrow as Group Chief Executive. I'll look at the main points before Iain takes a detailed look at the numbers. I'll then talk about our performance against our strategic actions, before handing over to John to talk about 2018.

2017 was a good year for HSBC. Reported profit before tax of 17.2 billion dollars was 10.1 billion dollars higher than 2016, due mainly to the non-recurrence of a number of large significant items. Adjusted profit before tax of 21 billion dollars was up 2.1 billion dollars, or 11 per cent, with increases in all four global businesses and four out of five regions.

A strong revenue performance helped us achieve positive adjusted jaws of 1 per cent in 2017, more than covering increased business investment and higher performance-related costs.

Retail Banking and Wealth Management had an excellent year. Strong deposit growth started to benefit the bottom line as interest rates began to rise. We also continued to grow lending in our target markets, especially Hong Kong and the UK.

Commercial Banking adjusted revenue grew well on the back of an outstanding performance in Global Liquidity and Cash Management. Global Trade and Receivables Finance revenue stabilised after a difficult 2016, and we increased our market share in key geographies.

Global Banking and Markets grew adjusted revenue for the year, due mainly to the strength of our Transaction Banking businesses. Growth in the first three quarters of the year in Markets and Banking enabled both to withstand the effects of subdued market activity in the fourth quarter.

Global Private Banking adjusted revenue continued to reflect the impact of historical repositioning, but was broadly stable over the course of 2017, and grew by 10 per cent in our target markets.

Adjusted loan impairment charges were significantly lower than 2016, due mainly to improved conditions in the oil and gas industry in North America. Our strong common equity tier one ratio of 14.5 per cent included the effect of recent changes in US tax legislation, which reduced our capital position by 9 basis points. It was also net of buy-backs throughout the year, which totalled 3 billion dollars in 2017.

Our policy is to consider buy-backs where appropriate, subject to the execution of targeted capital actions and regulatory approval. We plan to issue between 5 and 7 billion dollars of Additional Tier 1 capital in the first half of 2018.

The programme of strategic actions announced at our Investor Update in June 2015 concluded at the end of 2017. We completed eight out of ten actions on time and on or above target. We also completed the exit of Household through the run-off of our CML portfolio.

Iain will now talk you through the numbers.

Iain Mackay, Group Finance Director

Thanks Stuart. Looking quickly at some key metrics for 2017: The reported return on average ordinary shareholders’ equity was 5.9 per cent, up from 0.8 per cent in 2016; The reported return on average tangible equity was 6.8 per cent, up from 2.6 per cent; On an adjusted basis, we had positive jaws of 1 per cent; and we had a tangible net asset value per ordinary share of 7 dollars and 26 cents, up 34 cents on 2016.

Slide 3 provides detail on the items that take us from reported to adjusted for both the fourth quarter and the full year. You’ll find more details of these adjustments in the appendix. The remainder of the presentation focuses on adjusted numbers.

Slide 4 breaks down adjusted profit for 2017 by global business and geography. Adjusted profit before tax was up by 2.1 billion dollars, or 11 per cent, due to higher revenue and lower loan impairment charges. All four
global businesses grew profit before tax. Retail Banking & Wealth Management had a particularly good year, with a 24 per cent increase on 2016. Commercial Banking also registered a strong performance, with PBT growth of 15 per cent.

Slide 5 looks at fourth quarter profit before tax, which was 807 million dollars higher than the fourth quarter of 2016. This was driven by a 10 per cent increase in revenue. Four out of five regions delivered higher profits in the quarter. The reduction in Europe PBT was driven by a weaker Global Banking & Markets performance, which included lower revenues in FICC and two large impairment charges.

Slide 6 looks at revenue. Fourth quarter revenue from our global businesses was 400 million dollars, or 3 per cent, higher than last year’s fourth quarter. I’ll go through each business in more detail in the next few slides.

As slide 7 shows, Retail Banking and Wealth Management revenue grew by 8 per cent in the fourth quarter compared with the same period last year. Wider spreads and higher balances in Hong Kong helped grow revenue from current accounts, savings and deposits by 370 million dollars. Income from investment distribution increased by 98 million dollars from higher sales, particularly in Hong Kong. We grew customer lending and customer deposits by 7 per cent and 5 per cent, most notably in Hong Kong and the UK. Lending revenue was 117 million dollars lower due to margin compression. For the full year, revenue was up 9 per cent, with strong performances across the business.

Commercial Banking revenue was 11 per cent higher than last year’s fourth quarter. Global Liquidity & Cash Management had another excellent quarter, growing revenue by 16 per cent through higher spreads and balance sheet growth in Asia. Credit & Lending grew by 5 per cent, due mainly to balance sheet growth in Hong Kong and the UK. Global Trade & Receivables Finance revenue was broadly stable, as strong asset growth in Asia compensated for the impact of repositioning activity in the Middle East. Full year revenue was 5 per cent up on 2016, mainly driven by Global Liquidity & Cash Management in Hong Kong.

In Global Banking & Markets, the diversity of our product range helped us withstand the impact of subdued trading conditions in the fourth quarter. Revenue was down against a strong fourth quarter performance in 2016, although our Transaction Banking products continued to generate increased revenue from higher balances. In particular, Global Liquidity & Cash Management revenue grew by 18 per cent, and Securities Services grew by 15 per cent.

Lower trading volumes and reduced volatility affected FICC revenues, especially in Rates. Global Banking & Markets’ fourth quarter return on risk-weighted assets was 20 basis points higher than the same period last year, and the business delivered a return on tangible equity of 10.6 per cent in 2017.

Revenue for the full year was up 3 per cent on 2016, mainly in Global Liquidity & Cash Management and Securities Services. All our Global Banking & Markets businesses grew revenue in 2017.

Global Private Banking revenue grew by 2 per cent compared with last year’s fourth quarter. We grew client assets in Global Private Banking for the fifth consecutive quarter, and saw positive inflows of 15 billion dollars in our target markets in 2017. Revenue grew by 8 per cent in our target markets in the fourth quarter, particularly Hong Kong, and by 10 per cent over the full year.

Corporate Centre revenue grew by 695 million dollars compared with the fourth quarter of 2016. This was principally due to the non-recurrence of a net negative 684 million dollar income reduction in valuation differences on long-term debt and associated swaps in 4Q16. Balance Sheet Management revenue fell by 167 million dollars. This was due to the non-recurrence of a gain in last year’s fourth quarter, and repositioning activities carried out earlier in 2017. We have now completed the run-off of our sub-prime US CML portfolio, the principal legacy of the 2003 Household acquisition. As a consequence, associated revenue was 129 million dollars lower than last year’s fourth quarter. We’ll complete the wind-up of the Household legal entities in the coming quarters.

Slide 12 shows net interest margin, which is broadly stable. Net interest income of 7.4 billion dollars was 260 million dollars higher than the third quarter. Our net interest margin for 2017 was 1.63 per cent, 7 basis points lower than 2016, excluding Brazil. NIM fell by: 3 basis points from the impact of the CML run-off, and margin compression in Europe and Asia; 3 basis points from the higher cost of debt; and 3 basis points from foreign currency translation. This was partly balanced by a 4 basis point increase from higher deposit margins.
particularly in Asia and Global Liquidity & Cash Management. There’s a detailed slide on NIM and more information on NII sensitivity analysis in the appendix.

Slide 13 looks at loan impairment charges. Loan impairment charges were 658 million dollars in the fourth quarter, or 27 basis points as an annualised percentage of gross loans and advances. This was 218 million dollars higher than the third quarter, due largely to two corporate exposures.

Slide 14 looks at costs. Our operating expenses excluding the bank levy were 296 million dollars higher than last year’s fourth quarter, reflecting additional investment to grow the business, and ongoing investment in digital and IT security. We achieved around 600 million dollars of cost savings in the fourth quarter, which helped support growth, and absorb the cost of inflation and investment in regulatory and compliance programmes. We invested a further 322 million dollars in business growth in the fourth quarter, mainly in Retail Banking & Wealth Management. Our total expenditure on regulatory programmes and compliance was 3 billion dollars, around 200 million dollars more than the prior year. We expect regulatory and compliance spending to remain broadly stable.

Turning to capital on slide 15, the Group’s Common Equity Tier 1 ratio was 14.5 per cent on 31 December, compared with 14.6 per cent on 30 September. CET1 capital reduced by 3.7 billion dollars in the fourth quarter, due mainly to the fourth quarter dividend and a reduction in the value of our deferred tax assets as a result of changes in US tax legislation. Implementation of IFRS 9, including benefits from classification and measurement changes, will result in a favourable impact on our CET1 ratio, applying the European Union’s capital transitional arrangements. The fully-loaded day-one impact is expected to be negligible.

Slide 16 looks at our Group return metrics. The return on average ordinary shareholders equity was 5.9 per cent, up from 0.8 per cent in 2016, and the return on tangible shareholders’ equity was 6.8 per cent, up from 2.6 per cent. Our return on tangible equity excluding significant items and the bank levy was 9.3 per cent. If we also exclude the impact of US tax legislation, our return on tangible equity was 10.2 per cent. We are now disclosing our return on tangible equity by global business. The numbers for 2016 and 2017 are on the slide, and there are more details in the appendix. All four global businesses improved their return on tangible equity in 2017, with double-digit returns in our three main businesses.

I’ll now hand back to Stuart.

Stuart Gulliver

For the remaining slides I’m going to summarise the outcome of our two and a half year strategic action programme, which concluded at the end of 2017. I’ll then hand over to John to talk about the year ahead.

Slide 18 provides the final report card in relation to our 2015 targets. By the end of 2017, we had achieved eight of the ten actions we set out at our 2015 Investor Update. This included actions to reduce Group RWAs, deliver cost savings, accelerate our pivot to Asia, and implement Global Standards. Our US bank profitability and RMB internationalisation revenue targets remain outstanding, although we have made significant progress towards completing both.

Slide 19 shows how we’ve increased both capital efficiency and capital strength. We exceeded our Group risk-weighted asset reduction target by more than 20 per cent, and our Global Banking & Markets target by 31 per cent. We’ve increased returns at the same time, growing our return on risk-weighted assets from 1.5 per cent in 2014 to 2 per cent in 2017. The reduction in risk-weighted assets has helped us build one of the strongest common equity tier one ratios in the industry, while maintaining a strong dividend and returning 5.5 billion dollars to investors in the form of share buy-backs.

Slide 20 looks at NAFTA profitability. While the low-interest rate environment has held back the US business, we’ve more or less doubled its adjusted profit before tax since 2014. We also achieved a non objection to our US capital plans as part of the CCAR process in both of the last two years, and in 2017 the US business paid the first dividends to the Group in more than a decade. A large part of our international business emanates from US customers, so it’s of huge importance to the Group even if that’s not reflected in the US legal entity’s numbers. We increased the international client revenue actually booked in the US by 10 per cent in 2017.
Our Mexico business is significantly improved, delivering higher revenue, higher lending, higher market share and higher profits. It has grown market share in both mortgages and personal loans, and achieved double digit revenue growth in International Subsidiary Banking and Multinationals. 2017 profit before tax of 440 million dollars represents real progress, with revenue up 34 per cent and lending up 38 per cent since 2014. The growth opportunity for our Mexico business remains significant.

Slide 21 shows that we have delivered on our commitment to achieve an exit run-rate for 2017 equivalent to our 2014 cost base. We’ve delivered run-rate savings of 6.1 billion dollars since 2015, more than 1 billion dollars above the top end of our Investor Day target range. This has enabled us to absorb the 2.5 billion dollars that we’ve invested in growth and business improvements, 2.4 billion dollars of inflation, and 1.3 billion dollars of investment in regulatory programmes and compliance over the same period.

We invested a total of 7 billion dollars in costs-to-achieve between 2014 and 2017. As well as removing costs from the business, this has vastly improved both our systems and the service we offer our customers. It has positioned the business to capture market share and grow revenue, while also improving life for our employees. You can find examples of how these programmes have made us a better bank on slide 35 in the appendix.

Slide 22 shows how our improved international connectivity has strengthened our market position. This is proof of the benefit of our global universal banking business model, which is tailored around the needs of large corporates that operate across our network. We’ve invested in our network to better deliver the kind of cross-border service that our clients want, while many of our competitors have exited the market at the same time. We’ve also simplified the business to improve control while retaining the benefits of scale. As a consequence, we’ve increased the proportion of client revenue that comes from international clients from 50 per cent in 2015 to 53 per cent in 2017. We’ve grown our market share in key trade finance markets, increased balances and captured market share in Global Liquidity and Cash Management, and maintained our leadership of the corporate Foreign Exchange market. We’ve also increased transaction banking revenue by 5 per cent since 2015, while 30 per cent of Group revenue now comes directly from transaction banking, up from 29 per cent two years ago.

Slide 23 shows how we’ve refocused the business back towards the bank’s heartland in Asia. We’ve grown our lending and insurance income in Hong Kong since 2014. We’ve rapidly grown lending in the Pearl River Delta, launched new products and established new businesses, including the first securities JV in mainland China to be majority-owned by an international bank. We’ve grown assets under management in Asia by 49 per cent and increased annualised new business insurance premiums in Asia by 32 per cent since 2014.

We’ve strengthened our position as the world’s number one bank for international renminbi business, and established HSBC as the best overall international bank for the Belt and Road Initiative, according to both Asiamoney and FinanceAsia.

To conclude, HSBC is simpler, stronger and more secure as a consequence of our strategic actions. We have strong revenue growth and a robust capital ratio. Our international network is better at connecting customers to opportunities in the world’s fastest-growing regions. Our investment in Global Standards and risk and compliance helped pave the way for our exit from the 2012 DPA with the US Department of Justice, although financial crime prevention and strong compliance remain a daily focus. Our business is now more capital-efficient and capable of producing stronger returns for investors.

With that, I’ll hand over to John.

John Flint, Group Chief Executive Designate

Thanks Stuart. So these results and the achievements of the last couple of years clearly give us a great platform to build on. With that in mind, there are five things to take away about the year ahead.

First, we’re doing a lot of work to refresh our strategy and accelerate delivery. The strategy we have is working. We need to keep evolving it and to deliver it at pace. We haven’t yet achieved our return on equity target but remain intent on doing so. That target therefore remains in place, as do our other targets.

Second, in an environment where we’re generating more revenue, we’re going to be better able to invest in growing the business, subject to achieving positive jaws.
Third, we are going to focus keenly on improving customer satisfaction in every business across the Group. We’ve been investing to speed-up approval times, simplify processes and significantly reduce bureaucracy - but as our Environmental, Social and Governance reports from last year show, we’ve got more to do to raise customer satisfaction levels. We’ll be disclosing more on customer satisfaction in our 2018 ESG Report in April, and aim to improve in all areas.

Fourth, capital discipline and positive jaws remain essential to achieving our return on equity target. We’re going to run the business more efficiently, absorbing inflation and as much of the cost of investment as we reasonably can.

We’re also going to keep investing in risk and compliance. We have a clear aim to be the industry leader for risk and compliance, and believe this can be a powerful competitive advantage.

Finally, the fundamentals of HSBC will remain the same as they always have - strong funding and liquidity, strong capital, and a conservative approach to credit.

I will update you further either at or before our half year results in August.

Stuart Gulliver

Thanks very much. So, we’re very happy to take questions.

Joseph Dickerson, Jefferies International

Hi, good morning, gentlemen. Just a couple of questions. So, firstly, we’ve had a few rate hikes, and the NIM was flat quarter on quarter in Q4. But if I look at the trend in NII, it was annualising in Q4, up about 15% year on year. So, I’m just wondering: what should we see as the trajectory of the NIM now that we’ve had the drag from the CML eliminated and it seems like there’s some reasonable momentum, particularly in Hong Kong on the NIM? So, any colour there about how to think about this over the next year would be very helpful, market impacts notwithstanding.

And then, secondly, just on the US, how many costs are associated with the legacy Household entities that you plan to wind up? And then, secondly, can you remind us how many costs were associated with the DPA? I know the Monitor is probably still in place but what are the net costs from those two aspects that will come out of the US business? That would be very helpful, thank you.

Iain Mackay

Okay. Net interest margin: I think, as the slide title suggests, we certainly feel, based on what we’d experienced in 2017, that we’re reasonably well positioned to benefit as rates move higher. The key drivers for 2017 are set out in the slide quite clearly: we have, as you point out, Joe, the residue of the diluted impact of running down the CML portfolio, which completed in the fourth quarter – that accounted for about three basis points of adverse movement on NIM; slightly higher costs of MREL – TLAC by another name – and that reflects the issuance during 2017, and that programme continues in 2018 to ensure we meet the regulatory guidance over the medium term; and then a little bit of impact from currency translation.

That’s the less favourable news. The more favourable news is in the last point, where we saw higher spreads coming through liabilities – our deposit base and surplus liquidity, principally – over the course of the year, and that was most notable within the US and then, to a slightly lesser extent, within Hong Kong as well. In addition, one of the things that we experienced in 2017 were tighter margins on the liability side on the UK balance sheet on the move-down in the bank rate in the middle of 2016. Seeing that adjusted upwards again in the fourth quarter of 2017, we’d expect to see some benefit of that coming through in 2018.

So, I think, in terms of how our balance sheet is positioned, and the pricing dynamics on the asset side of the balance sheet, and the positioning on the liabilities side, we’d certainly expect to see some benefit flow through from higher rates. So, if the Fed follows through on a market expectation of higher rates in 2018, we should certainly expect to see the benefit of that come through. The headwinds in that regard, some have been eliminated, as you point out. We’ll continue to issue MREL into the marketplace, which will slightly increase
the overall net interest expense that we incur in that space. But overall, we think we’ve got a reasonably positive trajectory.

We’ve provided more guidance on this on net interest margin in the investor deck and in the appendix to the investor deck, as well as on page 108 and 109 of the annual report and accounts, so more detail there, hopefully, for you to help on sensitivity analysis, Joe.

On Household, the wind-down really is a number of entities. Now, this is an organisation that operated on a state-by-state basis across the US both in terms of subprime lending as well as some of its insurance businesses, so there are quite a few entities to be wound down. But I think, in the round, the cost of winding down some 50 entities is literally in the rounding from an HSBC perspective.

As it relates to the DPA, you’ll recall that the penalty that was assessed on us in 2012 was 1.9 billion. The annual cost of the monitorship, which started in the middle of 2013 and will conclude in the middle of this year, has run in the range of $120-140 million per annum in the round, so we will continue to see some expense coming through in 2018 in that regard.

Alastair Ryan, Bank of America

Good morning. I certainly agree you’re leaving the business in good shape, Stuart, so almost I feel a little bad asking this question.

The buyback guidance is some of the least useful that we’ve had in quite some time. So, you’re coming off a streak of significant buybacks. I appreciate there’s this technicality around the AT1 issuance in the very short term but it’s tempting to read a significant shift into this. There’s new management –

Stuart Gulliver

So, no, that’s not what you should read it. So, literally – and John will just interject here in a moment – this is about the fact that there are technical rules around having AT1s in the market and not being able to buy back shares at the same time. So, there’s nothing cute about it at all. There’s no change in the policy. It absolutely isn’t the case that John Flint and Mark Tucker are abandoning what we’ve had in place for the last two or three years. And once that technicality has passed – once the market has replaced the seven-odd billion of AT1s that we want to do – then you would expect to see some form of buyback come along at that point in time, so do not over-interpret into it. And I’d just ask John to join in, since he’s sitting next to me here.

John Flint

Sure, Stuart. Thanks. Alastair, Stuart’s exactly right: you shouldn’t read any change in attitude towards our approach to capital management and the role of buybacks within that. But there is a technical reason why we want to get these – well, we want to get the AT1s done and, therefore, there’s a technical reason why we can’t announce a buyback at this point.

Alastair Ryan

Clear – thank you. Could I just follow up? And this might be a bit thick from me but you’ve already 180 basis points of AT1 out there. Seven billion is a lot to do. It would take you to well above the current allowable amount. And your CET1 is already so high that you’ve effectively filled your Tier 1 requirements with common equity, so it feels like there’s an awful lot of capital kicking around in the business. How do we scale that? You’re going to end up with very high capital ratios with all this new issuance, and you’ve already about 13 billion of surplus CET1, so is AT1 substituting for CET1 down the road or are you just getting stuff done now ahead of 2023 or whatever it is?

Iain Mackay

Part of it is just getting to those regulatory guidance in the medium-to-longer-term, Alastair, and part of it is just normal financing and refinancing activities within the liability stack of the firm as a whole. You will recall we did a buyback in the second half of last year, and that precluded some of the issuance activity which we may otherwise have wanted to do, so that goes to the timing around this. But it is really just in the general round of financing and refinancing activity as well as with an eye to longer-term requirements around AT1.
Alastair Ryan
Thank you – clear.

Robert Noble, Royal Bank of Canada
Good morning. Just on the extension of the DPA, is there any risk that this affects your ability to withdraw capital from the US or is that not an issue? And just in the commercial bank, the loan balance was flat. I was just wondering if there’s any specific reason for this, I saw the red inked balances but, even without that, it’s flat. And you pulled out a comment that said there was spread compression in Asia in the corporate bit, and I was wondering: has that improved on the assets side – the spread compression in Asia? Thank you.

Iain Mackay
So, last question first: it’s been fairly consistent, both within mortgages in Hong Kong, as well as corporate credit and lending in Asia over the course of 2017, there is a lot of liquidity doing the rounds not only in this part of the world but globally, and the pressure has been consistent. We haven’t seen it intensify or slacken in that regard over the course of 2017. I think those competitive pressures remain fairly consistent going into 2018, based on the evidence so far.

On your first point, to be clear, the Deferred Prosecution Agreement that we entered into in 2012 with respect to AML, the charges in that regard were dropped in December of 2017, and that DPA has now come to an end on the back of the significant investment and work that was done in terms of improving the overall firm’s ability with respect to financial-crime risk management. As we discussed in previous quarters, our ability to extricate surplus capital from the US was very much informed by CCAR and having non-objections to the results of our stress tests and capital plans associated with those stress tests in previous years. And I think, as Stuart mentioned earlier on, we did get our first dividends from the US in 2017 since – I think 2006 or 2007 was the last time that a dividend was paid, so it is the first time we’ve had a dividend in 10 years, and we were successful in pulling quite a significant amount of surplus capital from the US, in line with those capital plans to which the Federal Reserve raised no objection in 2017. So, I think that covers that.

Was there a third point that you had?

Stuart Gulliver
Yes, it was loan advances growth in Commercial Banking. It’s up 7%. It’s up US$22 billion net.

Iain Mackay
And that’s largely informed by growth in the United Kingdom. We saw some growth in Asia as well, but that was largely informed by a reasonably robust environment in the United Kingdom from a Commercial Banking outstanding Credit and Lending perspective.

Raul Sinha, JPMorgan
Morning, afternoon, everybody. Can I have two, please? The first is on loan growth. If I look at the underlying loan growth in Q4 across the Group, year on year I think you grew at 7%, which is, let’s say, at the top end of your mid-single-digit indication for ’18, if I’m generous. Within that, you’ve got 12% growth in mortgage balances in Hong Kong and 7% growth in the UK. How should we think about the composition of growth? Do you think that any of these individual areas that are growing is going to see material pickup or slowdown in 2018 relative to where you are today, or is it just a continuation of the trends that we’ve seen so far? I’m just interested in how you square the seven with the mid-single-digit guidance.

And the second one, if you want that as well, is just on thoughts on UK asset quality. I was wondering if you had any thoughts on some of the pressure that we’re seeing, especially in the business-services sector and construction. Do you think that, at this point, it is isolated incidents, or do you think that there might be more pressures building up from an asset-quality perspective in the UK? Thanks very much.
So, on UK asset quality specifically, excepting the two large exposures for which we made provision in the fourth quarter, we see a very stable credit environment and, dare one say, even slightly benign, more so than perhaps one would expect, and that has been consistent, again with the two notable exceptions, across Global Banking and Markets, Commercial Banking and Retail Banking and Wealth Management. I think, overall, we’ve seen a very stable picture across the business in the Americas. We’ve seen a slight uptick in Retail Banking and Wealth Management in Mexico, but that was expected on the back of the nature of business that we’re growing there, particularly within Retail Banking and Wealth Management, with a slightly higher proportion of unsecured personal credit in that particular marketplace. In Asia, very, very stable; a slight tick-up in the Commercial Banking space in Hong Kong, but again not characterised by anything in particular that would be worth bringing out.

So, I think, overall, other than the notable items that we mentioned in the fourth quarter, it’s a pretty stable picture. I think it would be entirely accurate to say that, with learning from that experience in the fourth quarter, we are, as our credit teams always do, taking a good look at second order impacts that may emanate from particularly one of those names. But at this point in time, a reasonably stable picture.

Going back to Credit and Lending growth, I think one thing which does not necessarily show up by an examination of the fourth-quarter balance sheet was how strong credit and lending in Global Banking and Markets in Asia had been last year. In the fourth quarter, we saw a number of areas of paydown of credits in that Global Banking and Markets area, but the pipeline in Asia remains very strong in the Global Banking and Markets space and remains encouraging in Commercial Banking across the piece. And in Retail Banking and Wealth Management – and John could certainly go into more detail on this – we continue to see an opportunity to grow market share in the UK mortgage space. We continue to hold a very prudent position with respect to underwriting. LTVs for the portfolio overall are just around about 40%. New underwriting tends to be done at about 60% LTV. And overall experience in that book has been very, very stable. And as we continue to expand the broker channel – I think we now have 23 brokers that give us line of sight to the marketplace – we are seeing more of the market and are quite keen to continue to grow share in that space. Overall stock in the market is still slightly below 7% market share.

Iain thanks. So, maybe just to supplement that, on the RBWM side, mortgages in the UK, you should expect us to continue to compete aggressively there and to continue to take market share as we leverage back into the intermediary space – an area that we’ve been absent from for a while. We retain control of underwriting and we’re not compromising our credit-risk standards or our credit-risk appetite; we’re just getting more distribution through this new channel. And as we approach the advent of the ringfenced bank, if anything, the opportunity increases because the surplus funding of the ringfenced bank is now looking for a home and mortgages look to be a reasonable place for it. In Hong Kong, the market remains extremely competitive but we will defend our market share there. In our third biggest retail business, Mexico, there is still room for us to grow into our footprint. So, across the retail space, you should expect to see continued asset growth.

Thanks, John. That sounds very constructive but it what I’m struggling to square with is your current pace of growth looks like it’s running at 7%, and yet you’re talking about mid-single-digit, let’s say, an aspiration for 2018. Is that just conservatism baked into that forecast or is there something that I’m missing where you might be more cautious on?

7% sounds about mid-single-digit to me, doesn’t it, Raul?

Okay, fine. Thank you.
Chris Manners, Barclays

Good morning, everyone. It’s Chris Manners from Barclays here. Just two questions, if I may. The first one was on target capital levels. When I look at your slide deck, it looks like your MDA at 1 Jan next year is going to be 11.6%, and you’re indicating you’ve got a $25 billion surplus to that. I know, in the past, you’ve been talking about a 12-13% target range, and then you might run a little bit higher than that for a while. Just maybe a few thoughts on how much capital you think you need to run with longer term and how that ties back into the buyback.

And the second one is I had a couple of questions on the ringfenced bank. When I look at the ringfenced bank’s illustrative balance sheet, you do look like you have a lot of liquidity there; so, 25% of the balance sheet is liquid assets. So, how can you shift that out of the ringfenced bank or how can you make that more productive? And how much capital do you think that ringfenced bank is going to need? I see it’s got around £82 billion of RWAs. Is it going to just run at the Group CET1 ratio or are you going to run that a little bit higher? Thanks.

Iain Mackay

Okay. On the last couple of points, Chris, the guidance on regulatory requirement for common equity tier 1 in the ringfenced bank is in the range of 12.5-13.5%. Go around the houses: I don’t think you’ll find a ringfenced bank in the UK with different guidance in that regard. And as John pointed out, we do have a very strong liquidity position within the ringfenced bank, and part of the challenge will be profitably deploying that liquidity as the opportunity to move it further afield in the Group is restricted as part of ringfencing. So, absolutely, it will be part of the challenge to continue to look at how we optimise the ringfenced bank balance sheet and put to good use the resources that we have in it, but it would be fair to say we have a very safe balance sheet going into the start of trading with that bank on 1 July this year.

On the Group’s common equity tier 1 ratio, I think, certainly over the course of the last 12 months, we’ve tried to encourage you to think about the top end of our 12-13% range from a common equity tier 1 perspective. And certainly, if we reflect on the output of regulatory buffers on the back of stress tests, then the tendency has been to move the Pillar II requirement a little bit higher on the back of those stress tests. And I think that’s broadly what we would expect to experience again as we work through 2018. So, I think we are nudging the common equity tier 1 requirements for the Group probably somewhat above 13% at this stage. How much above 13%, we’ll get better indication when we get some guidance from our principal regulators around how they intend to interpret and apply the learnings from the stress test of 2017. We’ll hopefully get some guidance on that over the course of the coming months, but I think it would be fair to say that we would expect to see that common equity tier 1 ratio for the Group nudge somewhat above 13% now.

Chris Manners

Okay. So, maybe you’re comfortable with 14-ish for the moment. Is that fair?

Iain Mackay

You keep trying to put words in my mouth, Chris. I don’t think I said that, did I?

Chris Manners

So, it’s above 13. It seems to be the next place.

Iain Mackay

What – you don’t like anything between 13 and 14? Never mind. Broadly speaking, I think what we said earlier around the fact that we don’t really see that impacting our overall policy with respect to capital management and the propensity for buybacks.

Magdalena Stoklosa, Morgan Stanley

Good morning. Thank you very much. I’ve got two questions. One is about the investment for growth and another about year-to-date trading. So, the first one: when you look forward and talk about the investment for
growth in 2018 and ‘19, could you give us more detail about the extent and the nature of your key spend items, and maybe a little more colour, more detail around your digitalisation policy? So, that’s question one.

And question two: how do you see the beginning of the year in trading activity in particular? We have seen resurgent volatility but still against very strong underlying economic activity, so how have you started and how do you see particularly trading across 2018? Thank you.

**John Flint**

Magdalena, it’s John. I’ll start with the first question: so, our investment spend. What I won’t do today is talk about anything that relates to the development of the strategy, so that’s something that we’ll work with the Executive and the Board on over the next few months and then update everybody at or before the half-year results.

But what we have been doing over the last couple of years is investing in new technology and bringing technology into the bank to make it easier for customers to bank with us and to automate processes, either to reduce headcount or to make it easier for staff to get on and do their jobs. Last year, we spent around about $5.3 billion on technology as a function. We’ve invested over $2.3 billion in digital across our three biggest businesses over the period 2015-2017.

Some examples of what we’ve been spending our money on and where we’ve got a bit more work to do: we are the biggest financial-services user of biometrics, so that’s touch, voice-recognition and face-ID. 40% of our retail customer log-ins are now password-less. We’ve got the largest deployment of mobile-pay solutions of any retail bank in the world. In Hong Kong, where we’re hosting this call from, we have a new peer-to-peer mobile application, PayMe, that allows customers to send money to their family and friends etc. So, those are some investments that have been rolled out. We have similar work in train. All of that investment, of course, will be subject to the positive-jaws constraint. If the revenue environment remains constructive, we should be able to continue to bring new technology and to make the Bank better. We’ll maintain the positive-jaws discipline and, when we get to the strategy update, if there’s any change in the priorities of what we’re investing in, we’ll let you know then.

**Magdalena Stoklosa**

But, John, can I follow up very quickly? It looks like the investment over the last two years has been very much about kind of safety, security and front-end, and i.e. the customer satisfaction you’ve talked about earlier in the conversation. How about the back-end, how about the kind of middle and back office spend, which kind of tends to – or which kind of tends to be following the front office investments. Is that something that is also kind of happening in the background to the same degree?

**John Flint**

Yes, it is very much so. So, the things that are visible to you and to our customers, the things you can see, are part of it, but an awful lot of the investment has gone into the middle and the back end processes either to improve the technology platforms that support the business and/or to automate processes that are currently very manual, so there is an awful lot of that going on.

**Iain Mackay**

Yeah, there is a very significant amount of investment in the area of meeting regulatory compliance requirements simply with respect to the amount of reporting that we now do for our regulators around the world, whether it’s in respect of capital, risk-weighted assets, liquidity, overall exposures from a credit perspective. So, improving the speed, reducing cycle times, enhancing data quality and being able to provide multiple different cuts of data – which of course has benefit as well to the business in terms of helping inform decision-making at products and segment levels – is an area where there’s been considerable investment over the course of the last couple of years.

**Stuart Gulliver**

There’s quite a bit of detail on slide 35 in the appendix, which gives you a bit of detail as to where some of the middle and back office expenditure has been.
Magdalena Stoklosa

Great, thank you.

Stuart Gulliver

And then you also asked how we’re trading so far this year, which Iain will give you a completely inscrutable answer to.

Iain Mackay

With those instructions… No, I think the first six weeks of the year have been fairly constructive. It’s… As you say, the volatility has contributed to higher volumes that we’ve seen coming through, so I think overall, certainly when you reflect on the daily runs that are coming through Global Banking and Markets, it’s a reasonably improving picture over the first six weeks of the year. Next question.

Fahed Kunwar, Redburn

Hi, I just had a couple of questions. The first is just following up on the margins. Obviously, you got good higher yield on the surplus liquidity in the year, but HIBOR since the beginning of the year has fallen quite sharply. It’s off about 50 bps from the beginning of the year. I’m just wondering… That deposit margin, particularly on the Hong Kong excess deposits – does that fall going forward? How does that play into the margins guidance you gave earlier overall?

And the second point was just around jaws. Obviously, very positive that the investment spend will be under the constraint of positive jaws, but at the moment consensus is close to 3% positive jaws for the next two to three years. I think you talked about on the call last time jaws of more like 1-1.5% from memory. Is that 3% reasonable or do you think it’s still a little bit elevated? Thank you.

Iain Mackay

Fahed, I think your memory is quite good, actually. I like that guidance quite a lot. Then from a NIM perspective there is some variability in terms of how the deposit betas impacts the overall flow through to our income statement. And clearly we’re responsive to market pressures in that regard, Hong Kong just as everywhere else in the world. But, broadly speaking, the guidance we offered is conscious of some of the dynamics we have seen over the last four or five weeks.

Stuart Gulliver

And if I can come in on HIBOR, so HIBOR was trading on average at 54 basis points in the first quarter of 2017, 40 basis points in the second, around 44 in the third. It got up to about 84 in the fourth quarter, spiked around 100 and is back at 80, so the 100 is the outlier. So, no, that doesn’t require us to change the guidance.

Fahed Kunwar

Okay, so the fourth quarter was the outlier. That’s very helpful.

Stuart Gulliver

Yeah, it was.

Fahed Kunwar

Thank you very much.

Tom Rayner, Exane BNP Paribas

Thank you. Good morning everybody. Can I have two questions, please? Just, firstly, to go back to share buy-back and the capital guidance, I notice you have repeated what has been your dividend guidance for some time, that you’re going to hold it flat for the foreseeable future. Obviously, though, that suggests a continuing capital build.
And one aspect I don’t think you were asked about with regard to the share buy-back was the fact you haven’t been able to finalise or tell us what the final Basel IV outcome is going to be. I just wondered, is there any issue about the uncertainty around the potential Basel IV impact that may be making you a little bit more cautious on sort of committing to the share buy-back. That’s my first question, and I have a second one on costs. I don’t know if you want it now or after.

**Iain Mackay**

Fire away, Tom.

**Tom Rayner**

Really I just wanted to try to get you to update – I know you’re still targeting positive jaws, but just the sort of potential size of those jaws, because obviously having taken out more than 6 billion per annum of costs already, I guess it gets increasingly difficult to find those new sort of gross cost savings.

You were talking about – or, John, I think you were talking about wanting to invest more as revenue improves, so my sense is that if we’re talking positive jaws we might be more 1% than 3%, but I’m just trying to get a feel for what you think the potential is there, please.

**Iain Mackay**

Yeah, Tom, I think 1%, 1.5%-2% was pretty good guidance around the jaws number, per the previous question. I think your read of it is pretty much spot on in that regard. To go much wider than 1.5% or so is probably beyond what we are thinking about.

In terms of Basel, whatever they call it now, 3.5 or IV, I don’t think per se that’s necessarily what’s colouring our thoughts around the buy-back; in fact, it’s definitively not. The reason we’ve given you for the buy-back is the fact that we’ve got AT1s that we’d like to get to market. The first half of the year in our experience has always been more conducive to getting both good demand and good pricing on those products, and there are listing authority regulations which simply preclude us from doing a buy-back at the same time as AT1s or vice versa, for that matter.

I think as far as Basel IV goes, as you probably know as well, if not better than I, there are over 60 areas of national discretion available now within the guidance that was published back in December. For an organisation that operates across 67 markets with some 40 regulators, the opportunity to apply national discretions across a broad range of dimensions within Basel IV creates some uncertainty for us. And I think when you look at how other institutions that have published their results already on this have given guidance it’s been pretty much along the same lines, that there are pretty broad discretions that can be exercised and therefore the outcomes can be uncertain.

For those that have provided guidance, I think what characterises them is they tend to operate in a relatively small number of markets and may have benefitted from some guidance from the regulators already. I think certainly our principal regulators around the world are still very much in the stage of working through their own policy application in this regard.

So, yes, there is some uncertainty in terms of the impact and as we get greater guidance we’ll be sure to provide you with some guidance when it becomes meaningful to do so, but that’s not what’s influenced our decisions with respect to buy-backs at the end of the year.

**Tom Rayner**

Okay, thanks very much.

**Iain Mackay**

Thanks, Tom.
Michael Helsby, Bank of America Merrill Lynch

Morning, gents. I’ve got two questions if I can. Thanks for slide 33, giving us the future sensitivity in the outer years to the future move in the yield curve, but clearly 2017 we saw rates moving already, which does imply, for want of a better word, already pregnant with higher net-interest income in the outer years, so I was wondering if you could actually quantify that NII benefit for us in 2018, 2019, 2020, like you’ve done in that slide.

And then secondly, I think, ex the 105 million of customer redress that’s in the NII in the fourth quarter, annualising at 29.9 billion, I think for all the reasons you’ve talked about, NIM now looks like it’s going up. I think, Iain, you talked about mid single digit being broadly in line with 7% loan growth, and obviously you’ve got an FX tailwind in the UK next year. It does imply that consensus NII of 30.6 billion looks extremely mean. I was just wondering if you thought that was a fair observation. Thank you.

Iain Mackay

Not necessarily, Michael. I don’t think we’ll necessarily re-cut the sensitivity table for you here and now, but when we give you the first quarter numbers we’ll be sure to re-look at that sensitivity table that we provide you on page 33 and update it for any developments that will have occurred or may have occurred between now and the first week of May when we get those results into your hands.

I think overall, going back to what we talked about on NIM at the beginning of this call, we come out of 2017 with a reasonably constructive position and a reasonably optimistic outlook for Fed policy movement in this regard, but, as you can see, you’ve got a clear basis of assumptions included on page 33, and I think that gives you the propensity to take that and then doodle with it in your spreadsheet if you’re so inclined.

Michael Helsby

Okay, so you don’t think that consensus NII in 2018 looks too low?

Iain Mackay

Not necessarily, at this point in time.

Michael Helsby

Interesting, thank you.

Iain Mackay

Thanks, Michael.

Ronit Ghose, Citigroup

Great, thank you. I just wanted to follow up. So, if consensus NII doesn’t look too mean, consensus cost definitely looks to low, right, Iain?

Iain Mackay

No, don’t think so.

Ronit Ghose

Okay. Now, two more questions –

Iain Mackay

Now, remember there’s FX impact that’s going to come through this, okay, so it is important to reflect –

Ronit Ghose

Right, right.
Iain Mackay

And I think we provided on page – the cost page within the deck, I think it’s page 14. The impact of applying the FX rates, particularly in the sterling-dollar block, that it would have if we applied the exchange rate on 14 February. So, that’s something that we’d always point out on the basis that we provide you with adjusted data on a constant currency basis – just to continue to reflect that within your models. And, as I say, as we work through the first quarter and have a few months of trading activity behind us a better sense as to how the year is playing out, we’ll continue to update you as we get to that point in time.

Ronit Ghose

Sure, I get that, but I’m just looking at where… Just going back to your comment on jaws, which you repeated a couple of times, consensus jaws is clearly quite a bit broader than your guidance, so I’m guessing that the consensus cost number rather than the consensus revenue number is where the difference is versus your expectations, but you don’t have to comment on that.

The question I had was specifically one on MREL, please, Iain. Before you guided to the lower end of the 60-80 billion range, I think. Is that still intact or are we going to get more MREL issuance?

And I have a second broader question – maybe that’s more for your incoming CEO – about Open Banking in the UK. HSBC is the only big bank who has done much on this front, and I just would love any colour or anecdotes on how you guys see that playing out, Open Banking PSD2, for you in the UK this year. So, MREL, 60 billion…

Iain Mackay

So, MREL range, 60-80 billion – I think that range still holds true. At this point, we have one of our principal regulators that has provided us with some reasonably firm guidance on MREL and the positioning of MREL across the Group, and that’s the Prudential Regulation Authority in the UK.

There’s a consultation document out there from the HKMA, which we’ll get firmed up as we move through the year, and probably very much towards the end of the year, actually, which would be helpful, as well as an expectation of improved guidance from the US. But I think the 60-80 billion range remains an appropriate range to work on. I’m not sure I would guide you necessarily to the lower end of that range, but certainly within that range is where we see it right now.

I think in terms of cost guidance, we’ve sort of given you the tools here. We hit the exit run rate that we talked about, so excluding the incremental investment that was largely focused within Retail Banking and Wealth Management and certain digital tools in the fourth quarter, we exited 2017 in line with the 2014 expense base, so around about 7.5-7.6 quarterly run rate. And if you think about that continued investment in the growth of the business bring bound by 1%, 1.5%, 2% positive jaws, then don’t multiply 7.6 times 4. Think about revenue growth and the propensity for us to continue to invest into that growth whilst maintaining a positive jaws of 1% or so.

And with that, I think it gives you the ability to model out what that may look like with a reasonable degree of accuracy as the results flow through.

Ronit Ghose

That’s totally clear, Iain. Thank you for that.

John Flint

So, with respect to the question on Open Banking, open banking is here. You know, the regulatory direction of travel on this one is clear. The potential disruption that this could cause, we think, is quite significant, so it’s therefore important for us to be in early, testing and learning and experimenting with this.

So, we’ve currently got three aggregation platforms trialling. We’ve got one in the UK called HSBC Beta, which we launched in September last year, which allows customers to see all of their accounts on one screen no matter who they bank with. And, from our perspective, it’s important that our customers aggregate through us.
This is all ultimately about control over the customer relationship. So, we’ve gone out early. I’m very proud of that. We just need to test and learn and see where we can take that.

We have something in France called Personal Economy that we’re doing in partnership with a fintech, and our ‘first direct’ brand in the UK is also trialling a proposition that’s currently in the FCA sandbox. So, our attitude towards this is, we need to test and learn and be reasonably agile in our thinking. We’ll keep you updated as we learn.

Iain Mackay

Next question.

Martin Leitgeb, Goldman Sachs

Yes, good morning. Also two questions from my side, please, and the first one is just to go back to your UK proposition in light of upcoming ring-fencing access and deposit base within the ring-fence and your strategy on mortgages. And I just wondered if you could shed a little bit of light on the launch of the new intermediary mortgage platform, which I think has successfully launched in 4Q.

And I was wondering if you could give us an indication on what you think your market share could get to in terms of mortgage lending, because as far as I’m aware in direct lending you have a market share of around 20% at the moment in mortgages in the UK; in terms of indirect origination, via brokers, it’s around 1-2%. And I was just wondering, the new platform you have launched – where could that potentially get your market share in terms of intermediary lending in mortgages in the UK?

And the second question is just a follow-up on slide 33 and incremental disclosure on NII sensitivity over time. And I was just wondering if I read this correctly. So, for any potential rate hike you would get the benefit, around 50-60% of the benefit, coming through in year one with the remainder over the next coming years. And I was just wondering if that is an indication if you have a fairly limited amount of structural hedging in place. I would typically expect that the feed-through could potentially be slower with structure hedging in place. Thank you.

John Flint

Martin, okay, it’s John. I’ll take the mortgage platform first. I’m not going to give you a number as to where we think we can take the market share to. I think we probably… Well, the figures show that we took our market share of approvals from 8% in 2016 up to 9% during the course of 2017, so we’re up roughly 1% on the year. We’ve got – we still have funding and capital to allow us to continue to grow in the UK, so we’ll just continue to see that trend, but I don’t want to signal a number or an end date for that.

With respect to the new platform, the platform was launched probably 12-15 months ago and it’s recently been upgraded. Too early to give you any kind of indication as to what that’s going to do to production, but any upgrade clearly is going to help.

Iain Mackay

Martin, on the structural hedges, we do have a number of markets with structural hedges, and most notably in the UK. We do not have structural hedges within the Hong Kong marketplace. So, that may inform your question to some degree.

Martin Leitgeb

Very helpful, thank you very much.

Iain Mackay

Thanks, Martin.

David Lock, Deutsche Bank

Thank you very much for fitting me in there. So, I had two on the US. The first one was just on HSBC USA. The Core Tier 1 looks like it’s fell from 15.3 to 14.2 quarter on quarter. I just wondered if you could clarify what the driver was of that change. Is it an upstream to the Group or is it a reflection of the US tax change?
And the second one was on the US tax change. I just wondered if it was too early or if you maybe had any initial thoughts on what you thought the impact could be for your long-term tax rate and if there are any BEAT implications, particularly given you obviously fund a lot of the Group out of the holding company. Thank you.

**Iain Mackay**

So, the answer to your first question is that the upstreaming of surplus capital was the driver of the reduction in the capital ratios within the US.

And then on the tax change, we had about 1.2 billion/1.3 billion impairment on the deferred tax assets in the US. Obviously, in the longer term, as we continue to improve the profitability of the US business, a lower corporate tax rate ought to be beneficial. One of the things we are working through with a number of our peer group is to understand detailed guidance which is yet to be received from the IRS around the application of BEAT and various thresholds apply within that calculation. As I’m sure you know, it’s a fairly complex set-up and the piece of legislation that’s been put in place with respect to BEAT.

So, we are still working through whether or not it bites for HSBC. If it doesn’t, then obviously we clearly benefit from a lower corporate tax rate going forward, but we do need to have a clearer read on the guidance from the IRS before we make that final determination.

**David Lock**

Thank you – just a couple of follow-ups. Could you just confirm the dollar amount that was upstreamed?

On the BEAT, I just wondered – obviously, if this works out that actually it is negative for you because of the way the funding would be transferred from Holdings into the USA business, would you consider issuing locally in order to effectively optimise that or is that not simply something that would work from a regulatory perspective?

**Iain Mackay**

It would… Certainly, US regulation with respect to TLAC would conceivably allow us to do that. We do have a SEC-registered entity in the US that has in the past issued senior notes into the marketplace, so it’s not beyond the bounds of possibility, but we certainly would take no action in that respect until we’ve got a clear understanding of exactly how BEAT would apply. And there are a number of areas of ongoing consultation and clarification being sought from the IRS in terms of how it’s going to be applied in that regard.

In terms of the total amount of upstreamed capital from the US, in 2017 it was around $4 billion.

**David Lock**

Okay, thank you very much.

**Iain Mackay**

Thank you.

**Stuart Gulliver**

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

**Forward-looking statements**

This presentation and subsequent discussion may contain certain forward looking statements with respect to the financial condition, results of operations and business of the Group. These forward-looking statements represent the Group’s expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Additional detailed information concerning important factors that could cause actual results to differ materially is available in the HSBC Holdings plc Annual Report and Accounts 2017. Past performance cannot be relied on as a guide to future performance.