Transcript

Fixed Income 2018 Results

Conference Call with Analysts and Investors hosted by Ewen Stevenson, Group Chief Financial Officer

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HSBC

Ewen Stevenson

Thanks, everyone, for dialling in today. As you all know, it's my first Fixed Income Call with you in my new role at HSBC. I am joined today by a couple of colleagues: Iain MacKinnon, Group Treasurer, and Greg Case, Head of Fixed Income Investor Relations, who I'm sure you both know well. There's a Fixed Income-specific slide pack available on our website. I don't plan to speak to specific slides in the introductory comments. We'll keep comments brief - you'll have had the chance to listen to the Equity call we had last Tuesday. I plan to run through a few of the high-level points, then I'm going to hand over to Iain MacKinnon for a bit more detail before opening up for Q&A.

On our full-year results, and despite a weaker fourth quarter, we consider the full-year progress continues to reinforce our credit story. We grew revenues by 5%, to $53.8 billion; we grew pre-tax profits by 16%, to $19.9 billion; earnings per share by 31% to 63 cents; and our return on tangible equity by 1.8%, to 8.6%.

We achieved good top line revenue growth where we wanted to grow. To give you a few numbers on that, we grew revenues in Hong Kong and Mainland China by 14% each, Retail Banking by 13%, Commercial Banking by 12%, and International Customers by 7%, and the UK ring-fenced bank by 7%. This top line growth enabled us to afford higher investment spend. We're investing substantially at the moment into both growth and our digital transformation. Investment spend was up 10% last year, to $4.1 billion. Overall cost growth was 5.6%, which was in line with planned spend for the year, but with an unplanned 8% drop in revenues in Q4, largely due to adverse markets in November and particularly December, we saw negative jaws of 1.2% for the full year. We achieved loan growth of 8% while only growing RWAs by 2%, which helped underpin our CET1 ratio 14% at year-end.

Credit conditions remain benign in most places. Our annual ECL charge was only 18 basis points, well below our through-the-cycle guidance of 30 to 40 basis points. The only market we see any softness currently is the UK and, with more conservative forward economic guidance underpinning our IFRS 9 modelling, we took an additional overlay of some $165 million for the UK in Q4. That's in addition to the $245 million opening adjustment we took at the start of last year.

On dividends, we declared a final dividend of 21 cents, maintaining our annual dividend stable at 51 cents.

And with that, I'll pass over to Iain.

Iain MacKinnon

As Ewen said, we ended last year with a very strong balance sheet. CET1 ratio was 14%. We still have – enjoy a very strong pool of high-quality liquid assets of about just under $600 billion: $567 billion. The LCR is running in the mid-150s. During 2019 we achieved a number of milestones. We successfully completed our ring-fencing exercise in the UK. The result of that was that we managed to obtain a stable rating with HSBC Holdings, and the non-ring-fenced bank's rating remained unchanged after the separation.

Last year we issued $19 billion of HoldCo senior debt, MREL, and $6 billion of AT1 most of which was used to replace previously issued AT1. So we are now looking out to next year and we expect to be issuing somewhere in the mid-teens for MREL to meet ongoing MREL requirements, particularly in the UK and in Asia. We also expect to issue a small – a low number for AT1 to meet HBAP [The Hongkong and Shanghai Banking Corp] and HBEU [HSBC Bank plc] requirements. These are our Asian business and our non-ring-fenced bank in the UK.

So I think that's the outline issuance plan. We continue with the plan that the issuance should be done at the HoldCo level and downstreamed, although I would point out that we expect to issue senior from certain of our subsidiaries, notably France, Canada, Hong Kong and Mexico, and HSBC UK [HSBC UK Bank plc], which is currently deposit-funded and we would like to access commercial markets as well.

With that, I'll turn you all over to questions and answers, if I may.

Lee Street, Citigroup

Three please. Firstly, just in terms of OpCo sub debt, do you believe it works out an impediment to resolution if you've got OpCo sub debt written under UK law outstanding beyond 2021? I'm just thinking back to the Bank of England paper in December. That's number one. Number two: can you just remind us what type of buffer you intend to run for Additional Tier 1 and Tier 2 relative to your minimum requirements? And, just finally, just what timeframe would you expect to update the market on your plans for any further share buybacks? That'll be my three questions. Thank you.

Ewen Stevenson

Yeah, maybe I will take the third question and then Iain or Greg will pick up the first two. On timeframe for buybacks, we said last week, going back to our policy, our policy is to scrip-neutralise over the medium term through buybacks. We said last week that, given the uncertainty around Brexit, we wanted to pause with buybacks for the moment until we had greater clarity around the outcome for Brexit and the direction of travel, so I'm not going to get drawn onto specific dates as to when we feel we've got that clarity. And obviously all of this is subject to regulatory approval in due course.

Ian MacKinnon

Okay, I can deal with question two. With regard to the buffer on Tier 1 and Tier 2, it's fair to say that we haven't got complete visibility of the sum of the parts requirements that will apply to the Group, so you can't just look at 16% or 18% RWAs at the top of the house and then work your way up from that. We have to wait for further guidance from the various regulators that we deal with in establishing the sum of the parts answer.

So that's number one. And then number two, I would say that what's actually going to be happening, we will have Tier 2 maturing over the next 5 years, so we expect the Tier 2 to decline back to normal levels, and we would wait for the maturity, rather than buying them out at the moment, as being a better economic answer for us. So hopefully that deals with that, and then, Greg, maybe you can deal with question one.

Greg Case

Yeah, sure. So on OpCo sub debt, with regard to whether they're an impediment, I think this is going to be a piece of work that we'll be doing over the course of the next 12 to 18 months as part of our resolution planning and the report that we'll have to publish to the market next summer. Obviously, work is ongoing there and we're in discussions with the Bank of England. I think the definition of what is an impediment to resolution is not being formally defined as yet. We'll work with the Bank [of England] on formalising that and forming our own view.

Lee Street

Okay, that's all very clear. Thank you very much for your comments.

Ewen Stevenson

Thank you.

Robert Smalley, UBS

Hi. Good morning. Thank you for doing this call. I greatly appreciate it that you've done these and are doing them on a quarterly basis.

A couple of quick questions, again about issuance. You outlined your plans for this year and there was a bullet point in the presentation that seemed to intimate that you would like to get MREL issuance to approximate maturities. We don't have a lot of maturities in 2020, so should we look for a big decline there and then a ramp back up in MREL, or should it be kind of steady across the next couple of years? That is my first question.

Secondly, what would be some of the swing factors that would change that? You mentioned that you had some good balance sheet growth, but not a lot of RWA growth. Is China growth more RWA intensive or not, or is there anything else there that could be a swing factor?

And my third question is on AT1s. This year you're saying low single digits. Last year you did a fair amount of issuance. I'm just wondering how much more you can kind of force into the stack there after a very active year last year, and where do you see issuance 2020/2021, and can the market get a little relief? Thanks.

Ewen Stevenson

Well maybe I'll have a go at the second question and then hand over to Iain and Greg on the first and third. Yeah, I don't think there are any particular nuances and we've committed to the market that we're trying to grow RWAs at about 1% to 2% per annum. Yeah, that obviously represents the difference between gross RWA growth and net, with gross being the underlying growth in the portfolios that you referred to, net being after various mitigation actions including continuing to wind down certain legacy RWA pools, model approvals, etc. The only thing I would observe is while gross RWA growth is reasonably linear as the loan portfolios grow; net, it's very much dependent, quarter-on-quarter, depending on what mitigation actions are taken in any given quarter.

Of bigger influence, 1 January we had IFRS 16 taking back on balance sheet lease-to-own real estate. That had about a $5 billion increase in RWAs. We've obviously got Basel III reform on the horizon over the next few years. I would say Basel III is probably the much bigger influencer of future RWA trajectory than whether we see loan growth in China versus another market at this point.

Greg Case

If I can bucket your question one and question three together on issuance, so I think on the MREL side of things, I think on the MREL and on the AT1, we've tried to be a little bit more helpful in terms of giving a longer-term view on issuance. So yes, with AT1 we've said we want to do low, single-digit billions this year. We've also said that broadly we're comfortable with where the stack is. I'd underline the word 'broadly', given, with our balance sheet the size that it is, roughly speaking, 10 basis points of capital is about a billion, so the swing can be – it feels material for your guys, we don't feel as material. But yeah, broadly we're comfortable with where it is.

On the MREL side of things from senior HoldCo, we've said, 'Look, it's going to be early-to-mid-teens, in terms of billions, on an ongoing basis.' And then on slide 16 of the Fixed Income presentation we give the maturity schedule of the HoldCo senior side of things. So as we stand today we've got about $62 billion of HoldCo senior that's MREL eligible and about another $6 billion of stuff that was issued pre-BRRD, so you're talking about $68-69 billion of total debt.

This year we have no maturities, next year we have about five, and then from then on you're talking about being broadly flat in terms of an issuance profile on a net basis. So that's how we're thinking about things. We don't think that's a hugely material ask of the market from where we are today.

Ian MacKinnon

Yeah, if you look across the five years, we're looking at a net increase over the entire period of somewhere between $15-20 billion, and that's across the entire five years. There is obviously a lot of issuance on replacement of maturities and that would include replacement of what we currently view as senior and what we currently view as Tier 2. We think we've broken the back of the MREL issuance programme.

Robert Smalley

So this year, next year, seem to be the last two years that you'll be issuing more MREL than – well, that gap between issuance and maturities will definitely diminish as we get to 2021, 2022, but this year and next year with $5.1 billion, assuming that you'll still be looking at kind of a mid-teens number, it'll still be $10 billion or so, just for short-hand.

Greg Case

Yeah, that's broadly right, Rob, and the other thing I'd say is, while we are flagging that the OpCos will be issuing for funding in the next few years, we do still have a significant amount of OpCo maturities coming through, so I think it's fair to say the OpCos will be issuing less than the maturities. So in the HSBC name, it won't be quite that much either.

Robert Smalley

Okay. That's very helpful. Thanks and thanks for doing the call.

Will Boardman, Soros

Thanks for taking the call. Thank you, Greg. I also appreciate you doing it in US hours. On Slide 21 about Tier 2 you talk about the final implementation of CRR2 and the future path, and it may impact your plans. What are your current reads from what has been said on non-UK law language that exists in some of your long-dated Tier 2? That's my first question.

Second is on your LCR – your ratio – you're running at high 150s. Is that related to uncertainty around Brexit? And then, I guess, the third on the back of that: in terms of planning, if Brexit is extended for a long period of time, how will that impact how you run your LCR ratio going forward?

Greg Case

Sure. Shall I cover off one and, Iain, do you want to cover the –

Ian MacKinnon

I can do the liquidity piece.

Greg Case

On the CRR2 side of things, we're starting to kick off work now with our lawyers on looking at the entire stack. Obviously that's dusting off some of the work we did last May as well, but in terms of an initial view I don't think it's going to be hugely helpful for you, because what we review with our lawyers, in our final view, will be the binding one. So, if you don't mind, we'll leave that until we've got something more specific to say. But yes, I think it's fair to say we're looking at the stack, and there may well be some bonds that don't make the grade, but the six-year grandfathering period is helpful for us. It gives us time to think about what we want to do in the future, and also we still have a pretty chunky stack, so we still feel in a good place.

Ian MacKinnon

So on the 150% LCR ratio, I think you should view that as the reflection of what we're seeing in – particularly Asia, in Hong Kong, where we have a significant level of liquidity, plus the fact that we had to build liquidity out when we were putting together the ring-fenced, non-ring-fenced bank, and the uncertainty with Brexit where the Bank of England asked us to make sure that we held sufficient liquidity to deal with the uncertainty. It's fair to say that we're going through a methodology review and we will probably see the Group LCR metric fall back maybe 10/15%. It doesn't mean that we've lost liquidity; it's just a different methodology. We remain healthily liquid and we're just trying to monitor and balance the liquidity versus the cost of that liquidity.

Ewen, do you want to talk about Brexit generally or…?

Ewen Stevenson

I don't know what I could say to anything that – everyone will have their own views on this. There's obviously a wide set of possible economic outcomes coming from political decisions over the next few weeks and months. All we've tried to do with our IFRS 9 forward economic guidance is to take what we consider to be a relatively cautious stance. Just to reconfirm, we've now got an aggregate total of just over $400 million of IFRS 9 overlays in relation to the UK. That number inevitably will either be too much or too little depending on the Brexit scenario that results. We're trying to help our customers out in whatever way we can. Our own employees are impacted, potentially by – depending on what the Brexit outcome is.

We have a big operation – and have had for a long time – in France, so the sort of operational aspects of Brexit as it impacts us are not as complicated as they would be had we not had that business in France. We've got plenty of capital funding and liquidity. If you look at our Annual Report and Accounts you'll see pretty detailed modelling set out there about what the scenarios that we have modelled, but broadly under forward economic guidance we would normally have a 10% upside case, an 80% base case, a 10%

downside case. What we've done and what we've said was, because of the uncertainty that exists, we've got a 10% upside case, 50% base and three downside scenarios totalling 40%. Obviously the way that IFRS9 works is it's pro-cyclical, so what you're seeing is the impact of pro-cyclicality now coming through our ECL charges.

Will Boardman

Great, thanks. And then there is just one follow-up, talking about issuance specifically. You clearly issued and pre-funded in 2018, $19 billion of HoldCo and $6 billion of AT1. Why the change in language in not specifically targeting how much you're going to issue? You've given context but, I guess, on the senior HoldCo HSBC has been clear over the years of the size and scale, and is this more leaving yourself the optionality with Brexit uncertainty?

And then on AT1 specifically, do you have a stated buffer that you'd like to run? I think Barclays mentioned on their fixed income call that they would like to stay with a buffer. Will you give a stated AT1 buffer where you would like to run going forward as you approach your Jan '20 call?

Ian MacKinnon

Can I just try and deal with the MREL and the AT1? I think the numbers we're looking at – and you've mentioned the uncertainty before in terms of RWAs – but we expect to be issuing somewhere of the order of $12 billion to $15 billion this year, and I would expect it to be around $13-13.5 billion of that order for MREL, and on the AT1 we'd expect to issue $2 billion this year, because we can see specific need for that in the sum of the parts. We haven't actually been targeting a threshold above our regulatory requirements. It's simply been a function of what's an issue and what we can manage. And if I can remind you that last year we issued $6 billion, but we actually did retire in excess of $4 billion, so it was actually a net $2 billion by the time we finished.

Will Boardman

Great, thanks for taking my call.

Greg Case

Do we have any more questions?

James Hyde, PGIM

Thanks for taking this call. It's very helpful. First question – I've only got two questions and they're not major, but while I have you on the line… One of the global investment banking peers has called out the base effect anti-erosion tax – the BEAT – as a factor that's going to weigh on earnings. Is the potential for that to change your issuance structure gone? Are you just going to keep doing HoldCo as a potential for US HoldCo issuance because of that, or is it just your earnings now are not important enough?

The second question is Brexit again, but it's about the extent to which you guys are taking market share in mortgages. I'm aware that these are the lower LTV but does the Brexit development in any way mute your appetite for that? Did you have – had a clear impact on the competitive dynamics of the market?

Ewen Stevenson

Just on the second one first: on mortgages in the UK, the average LTV of new lending is about 65%. We're pretty comfortable with the risk profile. If we are seeing any softness in the UK at the moment it's in very selected sectors in commercial. The other thing I would say about the market share gains that we're taking in mortgages in the UK at the moment, we had a very limited presence in the broker channel until recently and we've built that up substantially in the last three years. We've got natural current account market share in the low double digits. We're currently at about a 6.6% share of mortgages, so we think our natural market share in mortgages is materially higher than where it is today, but the reality is that we have basically been operating in 30% of the market, which is our own origination, and until recently had not been an active participant in 70% of the market which has originated through brokers. So yes, we're taking market share, but I think in part that is because of the historical under-representation in the biggest channel for origination.

Greg Case

On BEAT, we're confident now that that we'll just be issuing out of Holdings. I think it's unlikely we'd need to issue out of the US, specifically.

Ewen Stevenson

Yeah, maybe just a final point on mortgages, you could also refer back to the Bank of England stress test last year where they do publish, I guess, an independent view on the stress portfolio of mortgage books across the UK banks. You will see in there that the stress characteristics of our book stood up very, very well, relative to peers.

James Hyde

Great. Thank you very much. That's very helpful.

Ewen Stevenson

Thanks all for joining the call, and if you do have any follow-up questions, please follow up with Greg and the IR team and we'll be happy to answer them on your behalf, but thanks, all, for making yourselves available today.