Transcript

Retail Banking and Wealth Management webcast

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HSBC

John Flint, Group Managing Director and Chief Executive RBWM

Good morning, good afternoon everybody. Thank you very much for joining us today. Before we get into today's presentation if I could just please draw your attention to the usual statement on forward-looking statements. I'm here today with John Greene, the CFO for RBWM, and I'll be taking you through the presentation. Then John will assist me when we get into the Q&A session later on. We have an hour scheduled, but my comments today will probably take about 20 to 25 minutes and then we'll get into the discussion.

In terms of the agenda today, there are three main pieces to this. We'll have a quick recap of the Group's Q3 results and I'll position RBWM within those to give you a sense of where we're contributing to the Group. I'll then give you a recap of the Group's strategy – or RBWM's piece of the Group strategy – and how we're executing against that. Then I'll talk through some of our priorities as we prepare now to head into 2014. When that's complete we will have a Q&A session.

So if we look at a quick reminder of the Group's results for the third quarter – you'll be familiar with these, so I won't take more than a minute. Year to date reported PBT was $18.6 billion, up 15% on the same period in the prior year, with underlying PBT up 34%. EPS up 22% at 71 cents and the Group producing an ROE of 10.4% off a common equity tier one capital of 10.6%, Cost:income ratio of 56.6% at Q3. They're the numbers that you've been through in detail before, so let's just dwell a little on the RBWM contribution.

The first thing to note is that because of the amount of transactional activity across our business, getting to a picture of the underlying business is perhaps more complex than we would wish, but if you can bear with me on this slide, I will take you through a disaggregation into the picture that describes the underlying. The top line shows that RBWM's contribution to reported PBT reduced from $7.9 billion to $4.9 billion over the first three quarters of this year, but you will recall that during last year there were significant gains recognised on sales from large transactions which closed in the first half of 2012. If you strip out those transactions and concentrate on what we call RBWM minus the run-off portfolio (rest of RBWM) you will see that we had a PBT of $5 billion for the year to date, down from $5.3 billion in the prior year. If we try and get to an insight into underlying PBT, which is the bottom red horizontal on the page you will see an improvement from $3.8 billion to $4.9 billion.

Just to recap our definition of underlying here, for those of you who are accounting-minded, we eliminate the effects of foreign currency translation differences, acquisitions, disposals and changes in ownership levels of subsidiaries, associates, joint ventures and businesses, and we exclude the changes in fair value due to movements in credit spread on our own long-term debt if the buy the Group and designate it at fair value. What we do not eliminate is the effect of customer redress. Therefore, the biggest driver in the improvement in the financials seen on the last horizontal there – the $3.8 billion to $4.9 billion – the most significant driver is the reduction in customer redress over the same period. So in the context of the Group that means that RBWM is generating 26.1% of the Group's profit year to date. You will recall at the May investor day we had indicated that by 2016 we expect RBWM to be generating between 25% to 35% of the Group's profit. We are currently sitting towards the low end of that range.

On a reported basis here we are generating very strong returns on risk-weighted assets. The table underneath the pie chart illustrates for the four global businesses at the half year – which is when we last disclosed – returns of 4.5% on a reported basis. This is currently sitting a little below the 2016 target of 5% to 5.5%, so I will just take a moment and explain why we remain reasonably comfortable that we can get into that range. I think between now and 2016 there will be two principal drivers for that improvement. One is we do expect – we certainly hope – that customer redress will diminish over time. The second driver should arise from the continued development of the Group's wealth business, which is typically very, very capital efficient. If there's a likely risk to us attaining that's target it's most likely to come, I think, from changes in regulatory capital treatment with respect to retail credit in its broadest sense, and perhaps mortgages more narrowly. But there's nothing on my radar screen; there's nothing imminent that I'm worried about that suggests that's the case, but I think if there is a risk to the exceptionally strong returns we generate I think it is likely to come in the form of a change in reg cap treatment. That's the numbers; that's what we've been producing in the context of the Group.

What I want to do now is just recap the strategy that we're executing to. The Group strategy has been very clearly communicated. The RBWM piece of it – we focused on three strategic priorities. The first is to simplify the portfolio of businesses. The second is to transform and standardise the retail bank and the third was to build out our wealth management business.

I want to start by looking at simplification. We have made very good progress in simplifying the portfolio of businesses across RBWM. We started out in 65 countries and we are now in 45. We have completed 43 exits from businesses or countries and two acquisitions – small acquisitions – along the way. This slide gives you a reminder of the businesses we have withdrawn from and businesses we've closed or sold. You'll remember that we made a significant reduction in our presence in Latin America and a significant change in the composition of the businesses within the insurance portfolio, exiting general insurance manufacturing and focusing on life insurance in seven core markets. So we've made very good progress with trimming the portfolio. This was necessary because back in 2011 when we started we had too many sub-scale businesses to effectively manage. I think it is worth noting that whilst we're very satisfied with the progress we've made we still have a work list of something like 20 or 21 projects that we're still working through. In financial terms, I don't think any of them are significant or noticeable, but in the context of making HSBC easier to manage or control it's very important that we carry on with the portfolio rationalisation that we've made a very good start on.

Now, as a result of that, that then leaves us with markets that we can prioritise or we can focus our time and attentions on. This colourful slide of maps gives you some sense of where our various country RBWM businesses are at in their particular journeys. I think in my conversations with investors, investors find it easier to think about RBWM in three distinct blocks: our Hong Kong business, our UK business and then the rest. Clearly the businesses in Hong Kong or the UK already have significant scale and significant profitability. I'll come back to the UK in a second, but there's no real issue about the scale or viability of those businesses. The more interesting discussions typically centre around what we're doing with the rest of the priority markets. This slide, as I said, illustrates where they are. The horizontal axis represents the scale of profits, with the mid-point splitting the countries between those that generate less than $100 million of PBT versus those that generate more than $100 million of profits. Then the vertical axis represents the returns. The top right box are the businesses that are currently generating the best returns and the best profits and, by definition, the bottom left are the businesses that are currently challenged. It is worth noting that the UK is in the box it's in – i.e. reasonably low returns – because of the effects of customer redress running through the numbers, but that aside, in normal conditions the UK is very comfortably in the top right box.

The key thing to note, I think, with the countries outside of the UK and Hong Kong is problem definition by country – the strategic challenge by country – is different. That means therefore there is no common diagnostic that we can apply to each of the countries. Each of the countries has its own specific business challenge. We remain reasonably comfortable that we have plans to get to either profitable scale or profitable niche businesses that are consistent with our model in each of these markets, but as you will be comfortable with by now, we are prepared to take portfolio decisions where things don't work or don't fit. This is the current map of priority markets for RBWM. We will remain commercial, pragmatic and disciplined around that, and if we have to take further decisions about the portfolio we will be happy to do that. In terms of the portfolio management piece of the strategy, it's gone very well and we're satisfied with the progress we've made. We are allowed now to focus on the priority markets illustrated on this slide.

What I want to do next is to begin to talk to you about how we standardised the retail bank. The starting point in 2011 was a very disparate set of businesses all operating under a common brand, but aside from the brand there wasn't too much that was truly common about it. Portfolio simplification has gone well. We've had to do an awful lot of other work to begin to standardise the business. We started, really, right back at square one. We started by re-writing the target business model and re-writing the target operating models. You will recall that the Group when through an exercise called 8x8, by which we redesigned the organisational structures that support all of the businesses across the Group – including RBWM. We've redefined fundamentally the human resource structure for RBWM and that did allow us to take significant headcount out of the business. Over the last three years one of the reasons we've been able to keep control of costs is that there has been a material reduction in headcount that supports the RBWM business. Increasingly, the structures that are being deployed across the various businesses and countries are consistent. So we started out with the human resource map and we have made significant changes there.

We've also been doing a lot of intensive work around simplifying the product range – i.e. what's on the shelf? What are you going to sell and deliver to customers? – because the product complexity, which I think in old times was seen as customer choice and therefore a good-for-all, actually has created unnecessarily complex levels of detail and complexity. We have been working our way back through that, simplifying what's on the shelf. In addition to that, many of you will be aware that we've also been changing fundamentally how we sell. We've redefined the sales processes across our wealth businesses, and I'll talk about that in detail a little later, and early next year we will also be making some significant changes to the sales processes that support the retail business. Of course, in lockstep with changing the sales process we've changed incentive schemes and we have led the industry in many aspects of this. Across our wealth businesses globally from 1 January this year we broke any mechanical link between product sale and incentivisation or commission payments to staff, so there is no longer a link there. We'll also be changing the incentive schemes for the retail businesses as we head into next year.

If you think that through – changing the way that we organise the human resource to support the business, simplifying the product shelf or changing what's on the shelf, redefining the sales processes and changing the incentive schemes – we have gone a long way to redefining how the front of the house works. With that behind us – or largely behind us – we can now start to make more progress in redesigning the back of the house – the processes that support this business. I think if we're honest with ourselves, historically we haven't got the order of this right. We've typically tried to start with the back of the house and deal with this as an IT problem and our experience has told us that we set IT an impossible problem to solve. This time around we've been a lot more disciplined about trying to simplify and standardise the front of the house. That will then allow us now to get into re-engineering some of the processes and, as indicated on this slide, that has allowed us to change the way that we organise the way the infrastructure that supports the contact centres, for example, mortgage re-engineering – the processes around that have been re-engineered across a number of markets. We can now do that because we've got greater standardisation at the front of the house.

Again, I'm satisfied with the progress we've made. I'm certainly pleased with the discipline that we've maintained throughout this, but I will acknowledge that we have more work ahead of us here than we have behind us. This is a multi-year programme of work and, whilst satisfied, we are by no means declaring victory here because, as I said, we genuinely have more work ahead of us than we have behind us.

So that was the second piece – transforming and standardising the retail bank. Let's take a moment now and just talk a little bit about wealth. Wealth is built around our Premier client base. I've got two slides on wealth – and just to remind everybody, this is wealth for retail clients. This is not private banking, so this is typically $100,000 of investable assets up to $5 million. It's not – it's very much defined around the retail client. When we set out our strategic objective of building the wealth business nearly three years ago we did that because actually at the time we had a disparate collection of wealth businesses then. Some of them were extremely good – very entrepreneurial, resonated very well with customers. Others were less robust. I think we have spent two years laying the foundations for a well-managed, robust, globally governed and risk-managed wealth business. I think that has laid the foundations for us to grow revenue reasonably well from where we are.

There are two dimensions that will allow us to grow wealth revenues. One is increasing penetration with our existing customers. We talked about that at the first investor day and said that's an opportunity. We have made some progress, but nowhere near enough and there's two ways to look at that. We can be frustrated with the lack of progress or we can be optimistic that the opportunity remains very significant. I'm choosing to be optimistic that the opportunity remains ahead of us, but as the bar chart on this slide illustrates there's also the possibility to grow our Premier base in many of our key markets – because other than Hong Kong I don't think we could claim to have reached anything like saturation yet with this key client base. The opportunity with respect to wealth remains extremely exciting and I think extremely compelling.

Let's just take a couple of minutes now to talk about what we're doing with respect to retail wealth because we have made a number of significant changes. As I indicated at the start, we had a disparate set of businesses. We've now been implementing a global consistent set of frameworks to govern the wealth business for retail clients and we are very clearly focused around needs-bases selling and around appropriate and very detailed risk profiles for clients. We've moved significantly away from a model in which the PRM – the relationship manager – was effectively the chief investment officer for his portfolio of clients to a model that is a lot more prescriptive and has greater boundaries and constraints delivered through the wealth framework. Any retail wealth client who would like assistance with managing their wealth will get from us helpful diagnostics around their needs, helpful diagnostics and tools around their risk profiles and then a range of solutions that fits.

In order to deliver that we made a very clear decision this time last year to change the way we incentivise our Premier relationship managers in particular because it's clear in my mind that unless you do make the change to the incentive frameworks that we've made you're conflicting your frontline staff. So I'll exaggerate perhaps a little to make the point here, but my concern would've been in the past on the one hand you tell staff that they need to be customer-centric and needs-driven in their activities, but at the same time you give them a tariff that says if you sell this you get *x* points and if you sell this you get *y* points. I think that's conflicting your staff – in fact I know it's conflicting your staff, and that's not the way to navigate running a wealth business into the future, particularly if you contemplate the advent of the conduct risk agenda that the FCA is now beginning to develop. It was very clear to us that we had to make that change, so all of our PRMs now have a balanced scorecard. They are incentivised to deliver around solving customer needs and making needs-based sales. There is no incentive to sell one product over another. The total relationship balance remains a key driver. That was a very significant change to actually put through the business, but the good news is that change is behind us. We've had a year of experience through it. The vast majority of our PRMs have come through and I'm actually quite excited now about the potential for using that platform as we head in to next year.

At the last investor day we indicated a $3 billion wealth target for 2016. We have generated – as the bar chart illustrates, top right – we have closed about $1 billion of that down, so we still have another $2 billion to get. That's a stretched target in the current environment because I think headwinds with respect of wealth have intensified a little, certainly in the context of the conduct risk agenda, but it's an aspirational target that I remain comfortable owning because I think the opportunity within our existing client base and within the target client base remains very, very strong.

So that's a quick recap on the three strategic priorities we've been running to. Simplifying the portfolio has gone well. We haven't finished. I think most of it's behind us, but if we have to take more action clearly we will – we have a track record in that regard now. Standardising and transforming the retail bank – gone well, but we have more work ahead of us than behind us. And wealth – we've spent a lot of money and energy building the foundations for delivering wealth effectively to retail clients in our key markets. We've got $1 billion of revenue growth behind us; we've got another $2 billion to get before we've made the first phase of this development complete. That's gone well.

But what we now need to talk about is two other issues before I close – two other issues I want to just bring to your attention as we think about 2014. As I've done various investor relations meetings over the last two or three months, I think one of the conclusions I reached is it would be a fair challenge to us as a management team that perhaps we haven't taken enough credit risk in the recent past. We have engineered a very thoughtful and deliberate de-risking of the book, pushing the pendulum away from unsecured lending to secured lending and, as a result, the credit book across RBWM is in very good shape. There are a couple of notable exceptions – we've had stress in Brazil and a bit of stress in Mexico, etc – but generally the books are in terrific shape, and I think it's a fair challenge to suggest that we could take more credit risk.

We've been very deliberate as well in the use of the words, 'relationship-led lending' because I don't want to signal that we're going to go off-piste now and start getting entrepreneurial in markets that we don't have any experience in. That is absolutely not the intention. This slide just tries to illustrate how we're thinking through the development of growing the pace, increasing the pace of relationship-led lending across HSBC. In our home markets of the UK and Hong Kong we have Premier, Advance and mass markets that we can deal with, but we are also being thoughtful then about segmenting the other markets and ensuring that we've got a credit risk approach that supports the desire to perhaps accelerate revenue growth somewhat by taking more credit risk. That's something that we're going to challenge ourselves to do as we head into next year.

I think, again, before we close we just need to take a moment and note where we are with digital because this is enabling us to, one, deliver on the strategy we're delivering and the change programmes, but also it's enabling us to deliver the $25 billion-odd revenues that we require to hit our financial targets. This time last year we were not comfortable at all where we were because we had a plan, but we hadn't managed to deliver much in the way of mobile technology and that was really where the big gap was. Thankfully now we've had a good year with respect to the rollout of our mobile platform. Those of you calling in from Hong Kong, I trust, are familiar with our platform there and the very rich functionality that exists. We're very proud of the Hong Kong platform, but actually that platform is available to all of our other markets as well and we're now increasingly developing the back-end connections so that we can use the same functionality and the same platform across all of our priority markets. By the end of this year, very shortly, we will have a mobile banking platform for phones and tablets available in all of our priority markets, which is a significant step forward.

Now, we are by no means finished. Again, I'm not declaring victory with this, but we've made good progress in the last 12 months. A fair challenge would be that we haven't yet begun to commercialise the benefits of this, but the advent of the new digital channel is catalysing the way that we think about the branch network. You can expect to hear more from us next year on the future evolution of the branch network, certainly in some of the markets that might be more challenged economically now. We own and operate over 6,000 branches across RBWM. It's not possible to make generalisations around the future of the branch network in general because each of the countries has a different diagnostic, but we are working with some external providers now to review and plan the physical distribution network, knowing that we've now got a digital alternative channel that we can use. So in digital we've made good progress and I hope, certainly by this time next year, to be talking to you more confidently about the commercial benefits of that.

To recap before we get into Q&A, we have made a good start to globalising RBWM and reinforcing its position in the Group. Current performance remains strong, with 20% of the Group's PBT and a very healthy return on risk-weighted assets. Portfolio simplification's gone well. Good start restructuring the retail bank, but more work ahead of us, and we've laid the foundations for a good global wealth business. The strategic objectives are not changing. They remain intact. We are exploring the potential to take more credit risk as we head into next year, noting again that there are some headwinds with respect of some regulatory interventions in key mortgage markets. The advent of the new digital channel, now that it's with us, will allow us to think a little bit more radically about the future of the physical distribution network in some markets. A quick reminder of the targets for 2016: a return on reported risk-weighted assets of 5% to 5.5% and incremental wealth revenues of $3 billion, of which we've achieved $1 billion already. They're what we're focused on.

Thank you very much for listening. I think I've said more than enough for now. I'd be very happy to take questions.

Questions and answers

Andrew Coombs, Citi

Good morning, John. I just have a couple of questions on slide eight, in particular your Brazil and US business. Firstly, on Brazil you talk about re-engineering that business, but clearly it's an area where you don't have significant scale. I think you've got about 800 branches and your peers are 3,000-plus. Clearly there's a lot of aggressive competition from the state-backed banks and it's also very expensive to reduce headcount there. I'm interested to know what you think you can do to re-engineer that business in particular. Secondly on Brazil, effectively, why not exit? Is it a case of the infrastructure and funding support that it gives to the commercial bank in that region?

Then just finally on the US – I'm just interested to know – once you run down the HFC book, essentially what's left? I know you're targeting a niche Premier account client base, but even if you look at the US Inc RBWM profitability alone, that business has been loss-making since 2007. I'm just interested to know what the end game there is for the US business.

John Flint

Thanks, Andrew. Brazil is clearly something that's getting a lot of attention now. You're absolutely right. It seems slightly bizarre to be talking about a business with 800 branches and noting in the same breath that it lacks scale, but you're right. In the context of that market that's where it is. We've had some issues with credit in Brazil, to be honest. I think some of the work we've done around credit over the last three to five years, some of the portfolio decisions we've taken and the bits we've expanded into have not been particularly smart. So there's been a change of management team with respect to regional RBWM business and with respect to country management in Brazil. Our current instincts are that if we can get the credit piece right, we can get RBWM back to being profitable at a reasonable level. It won't be occupying anything like this bottom left box. Actually, if you go back in history – if you go back only two or three years – Brazil would have been in a very different place on this particular map. So I think in substance, if we can get the credit piece right we can make a significant difference.

With respect to the second part of the question, 'Why don't you exit RBWM?' what you typically find – and I'll give the answer with respect of Brazil, but it would apply to others – the lines of business that we organise across the Group, they're an artificial construct in many ways. It's just how we chunked this Group up to try and make it manageable – what we do find, as you alluded to, is if you think about coming out of RBWM in a particular country the impact typically goes a long way beyond RBWM. So it's not just our direct costs and our revenues that we lose – there is the funding impact across the rest of the bank. You do then have a problem of stranded costs. I'll put it another way: in terms of the strategic diagnostic you would go through, you might say, 'Well, look, as a standalone business it's difficult for us to be enthusiastic'. If you go to the next level, at the bank level, it might still remain rational to remain open in order to keep the rest of the Bank funded because we have other businesses there that do manage to generate very, very healthy returns.

I guess the key answer is we're working hard on Brazil at the moment. It is one of the countries where we're looking at options for the branch network and how to configure that, but I think the big driver will be sorting credit out. The loss rates across our portfolio in Brazil are a significant outlier in terms of the rest of the RBWM business.

With respect to the US, it's a similar story. I'm glad you recognise that our niche is Premier. The good thing about the US is the available base of eligible Premier customers – even internationally-minded Premier customers – is very significant. We're still a very small player in a significant market. The current operating results are really driven by credit and in particular non-branch originated mortgages, which have been a big drag on the book. Year-on-year we are seeing improvements, but they're improvements that are consistent with a credit problem being digested through the python, if you like. We do have line of sight there to niche profitability in the US which is built around the Premier base.

Answering the strategic question about us in the US beyond that isn't somewhere I want to go today. I think in respect of RBWM, though, we can see we have got line of sight towards being profitable in the not-too-distant future, largely though credit improvement. Thanks, Andrew.

Chira Barua, Sanford Bernstein

I've got three questions if I may. The first one is on Hong Kong. When you are talking about risk sometimes you wonder – it's one of the most profitable retail markets in the world – what could be the risk in terms of fundamental market structure disruption and how sustainable are those returns, say for the next five years in that market, given light of competition dynamics which have changed as well. The second one is on Premier. I'd love to understand what is profitability in your Premier segment vis-à-vis the rest of the retail bank. The third one is speed to market in the sense that – I've checked out your Hong Kong app. It's brilliant, but here in the UK it's pretty much bottom of the line. What takes you so long to move your technology around the world if you're a global bank and why don't you have exactly the same platform across all your key markets? Thank you.

John Flint

Thank you, three great questions. Hong Kong disruption – I can assure you that we ask ourselves this question just about every day. I've been in the business 25 years and when I joined 25 years ago I remember we were very anxious about how we defended our position in Hong Kong then and the good news is I think our position's strengthened over that period.

I think – well, China with a question mark against it. A significant dislocation on the mainland will have an impact on Hong Kong, but you ascribe your own probability to that. I think Hong Kong is a very profitable market for a number of reasons. Society is happy to accept strong operating margins in its banking system. It's not reasonable to say it's not a competitive banking system – there are many banks in Hong Kong competing – but society's happy to tolerate reasonably healthy profit margins in the system because more often than not customers are also investors. Contrast it with some of the developed markets that we operate in – profits are not celebrated when we make them. The presumption is we've done something bad to get them. In Hong Kong the attitude is very much the other way round. 'Yeah, we'll celebrate your success and if we think you're making a lot of money we'll buy the stock as well'.

Is there something that's likely to challenge that? Near-term, no, I don't think so. I do think Hong Kong has got some interesting challenges ahead of it: potential for universal suffrage, everybody having a vote by 2017; there are some tensions emerging between those, if you like, who have wealth and those that don't have wealth in Hong Kong. So if you've got a very long-term lens on it you might be able to see perhaps some drivers for change there, but I think you need a long-term lens to see them. As I said, I don't anticipate any regulatory disruption. I think the regulator has been very pragmatic and commercial and continues to be so. They've clearly got a good track record. They've done a good job navigating Hong Kong through some extremely difficult periods. There's nothing imminent, but China with a question mark; I think societal change, particularly the stress arising from the gap between those who have and those that don't; and the potential for everyone to have a vote shortly I think could begin to change the way the markets work in Hong Kong, but I think you need a medium or long-term lens on that.

The second question was with respect to Premier, and we don't disclose a great deal, I'm afraid, around that. I mean, perhaps the best steer I can give you is that we clearly are spending an awful lot of time and energy on it. As I think you'd find with most segmentation work around the retail client space, it is the case that the clients with the biggest relationship balances and the greatest product penetration typically pay for the rest.

John Greene, Chief Financial Officer RBWM

John, if I may just add to help out with that, the revenue for a Premier customer varies by market place, but on average it's five to eight times the amount of revenue we would generate from a non-Premier customer. We like to segment a great deal; we're well placed for it and we're continuing to invest.

John Flint

The third thing around speed to market and the mobile platform – I'm delighted you like the Hong Kong one. The good news is the technology – if you like, the digital technology, the mobile code, etc – is consistent and that can be used everywhere else, but the challenge we have is when you bring it to the UK you then need to plumb that in to the UK's infrastructure. Because of the history of the Group our underlying infrastructure remains different in each country. The front-end piece of mobile we have developed in the right way – we've done it once; it covers all of our markets – but we still have the plumbing challenge that we need to get to in each of the markets. We're doing some work around that. We have a programme which we're investing a lot of money into next year – a GSP programme – which begins to simplify that, but the challenge or the criticism is right. It is a frustration for us too that we can have something as brilliant as we have in Hong Kong potentially available for everywhere else, but because of the plumbing problems it just takes us too long to get out there. That all speaks to the need to keep standardising the retail bank. We won't be able to make meaningful progress on speed to market until we've resolved that issue.

Thank you very much. Next question, please.

Chris Manners, Morgan Stanley

Good morning, John. I just had a couple of questions on UK retail and it was sort of saying in the *Guardian* that you were going to reveal a low-price help-to-buy mortgage, cheaper than some of the others. I thought I'd see what you think about competition in the UK retail market. I know you're talking about moving up the credit curve. Would that include higher LTV mortgages as well as the unsecured lending? Yes, maybe just a little bit of what you're seeing in the UK at the moment.

John Flint

Sure. We are supporting the Help to Buy scheme, so the press reports around that are right. We have two very competitive offers that'll be available for customers, going up to a 95% LTV. I think it's important for us at this stage to be supporting this initiative in the UK as a major player in the UK banking market. It's important that we're seen to support it.

Our risk appetite for any market, but in particular a market as large as the UK, is very clearly prescribed and we continue to operate well within our risk appetite. Competition is increasing. It's absolutely right to note that the mortgage market in particular in the UK is more competitive now than it was 12 or 18 months ago, and we have enjoyed a period coming out of the crisis where we pretty much dictated terms in the mortgage market in the UK and that's no longer the case. We are competing again. But we remain very focused on operating within our own risk profile. It's a market we know well – we've got credit histories and great analytics. We know what we want to do and what we don't want to do, so our capacity to increase even up to this 95% LTV, taking advantage of the guarantee between the 90% and 95% we have a finite appetite for that as well. This is a market that we continue to lean into, but within clearly defined risk appetite. The risk appetite for 2014 hasn't been signed off yet – that's what we do at this time of year – but you should expect us to remain focused on originating into this space, but within a very HSBC-like risk appetite.

Chris Manners

Thank you. Could I ask you maybe just one more question just about how you're thinking about the ring-fencing of UK retail and, you know, whether that would mean you have to have a carve out of the parent entity and how you think that could change the dynamics in the market as well.

John Flint

Ring-fencing clearly will change the dynamics, largely through creating discrete pools of capital to support fewer businesses. I don't think we've got sufficient clarity yet on the specifics around that yet to be able to talk in a meaningful way about the likely economic impact of it. The starting point is we have a retail bank that enjoys very strong underlying profitability. We've got to get through this period of redress, but once we get through that we have a retail bank which generates very strong returns. The two big drivers, though, for the medium to long-term profitability for the UK retail bank are likely to be the ring-fence and how it lands, but also how the conduct risk agenda eventually settles – i.e. what the regulatory tolerance is for what you sell, how you sell it and what the value exchange is. I think actually that second impact for me right now is getting more of our attention than the detail around the ring-fence. It's probably a bit too early, but that issue coupled with the conduct risk agenda I think do hold the key to the long-term profitability question.

John-Paul Crutchley, UBS

Morning, John. It's JP here. Two questions if I can. The first is actually a slightly high level question about the regulatory agenda about its legacy and compliance costs in the UK. Stuart's obviously talked about running the Group in terms of compliance architecture and in terms of global standards at the highest level to what applies anywhere in the Group. I just wondered: how do you apply the lessons that we've been going through in terms of the UK context in terms of PPI and other legacy-related costs in terms of how you actually conduct retail banking and [inaudible] elsewhere in the world so you're protected if that agenda were to start to permeate elsewhere?

That was the first question, and the second question was just about the return goals for 2016. Am I right to assume within that you're not assuming anything dramatically different in terms of the interest rate environment or have you got some assumptions built in behind that? I'm just trying to get a feeling for how much of this is about re-engineering or repositioning of the business versus – given that you have fairly significant deposits in the franchise – whether you're assuming a bit of a tail wind from a different interest rate structure.

John Flint

I'll answer that last one first, JP, because that's reasonably straightforward. We're not assuming the uplift from rate movements in that number. Clearly if they do come by then that will be an additional boost to those returns.

John Greene

Just to give a sense for the Group, the effect on our future net interest income of an incremental 25 basis points parallel rise in all yield curves worldwide at the beginning of each quarter during the 12 months from 1 July 2013 is about $1.2 billion, assuming no management response[1]. We don't disclose separately how much of that would be retail, but certainly based on the asset and liability base within the retail bank versus total Group it's a significant portion.

John Flint

Coming to your first question – this is a great question – I can assure you the agenda that's being developed in the UK is very significantly influencing our thinking with respect to the rest of the world because what we can see already is that the FCA is successfully exporting its agenda. Regulators get together on a regular basis – they talk together, they swap notes – and you can see some of the FCA's tone and content now starting to get played back through other regulators. We've expected that to be the case. I would say that even I'm a little surprised how quickly it's happening. Look, to be clear, I think the FCA and the PRA for me remain the most influential regulators in the world. Whatever you may think about that, that's what I observe; that's what I feel running a global business.

The conduct risk framework and to a certain extent our risk appetite are informed by what's happening here, but there's a tricky balance to achieve here because the FCA, whilst being our lead regulator for the Group, if you look at our business in Hong Kong, Brazil or France we are serving different societies there. Societies' expectations for what we do for them and how we do it, and the price at which we do it are different. It's absolutely not in our interests on behalf of the shareholders to just solve to the lowest common denominator. I think – I'm glad you asked the question actually because Stuart's very clear to make sure people understand that if the highest compliance standard is at a particular level, we'll default there because as a global international Group we don't really have a choice. But when you start looking at things like profitability or value exchange across markets, it's not our intention to bring everybody down to the lowest return on equity or the lowest profit share because that's not what societies expect.

My management team's challenge – the challenge we share – is to navigate this business into the future avoiding all of the potholes that we think might come. So we spend a lot of time and energy thinking about this. I think we're getting it broadly right now. What we're experiencing – the way it feels is that we are going ahead – because we have this ability to anticipate, because we can see what's happening in the UK we are leading the market in some areas and that means that we're giving up bad revenues quicker than others. If I look at the numbers this year there are reasonably significant revenues that we have left behind deliberately because we would be concerned that if we don't make changes they will be next year's redress or the year after's redress. So as well as growing the revenues we're are very deliberately trying to improve the quality and integrity of those revenues by using the FCA's conduct risk agenda to inform our thinking, but I don't want anyone to reach the conclusion that that means that we will therefore artificially depress returns in order to be able to say, 'Look, we've now got our Brazil business looking like the UK', because it shouldn't. It's serving a different society.

Next question, please.

Rohith Chandra-Rajan, Barclays

Good morning. I've got a few questions actually, just again around the return on risk-weighted-asset expectations for 2016. If I sort of add back the customer redress charge in the first half it looks like that would in itself add about 50 basis points, so it would get you to the bottom of the target range. And then adding $2 billion incremental wealth revenues would see returns rise to what looks like well over 6%, so presumably there's some cost offset there. So I have three questions, please, if I could. Just in terms of wealth management, you mentioned penetration from Premier in particular has been less than you expected. I just wonder what makes you more optimistic on wealth in general. It's a very competitive environment in all of these markets, so I'm just curious to understand what's really differentiated about the HSBC approach that will enable you to take market share. As a follow up to that, what's the conversion rate of Premier customers to wealth products to drive that $2 billion revenue uplift? That's the first one. Secondly, again coming back to the return on risk-weighteds to get to the top of the 5.0 to 5.5% range suggest something like a 50% cost/income ratio on the incremental $2 billion of wealth revenues. I just wondered whether that was roughly right. Then finally, just the other areas that you you've mentioned in terms of further inefficiency or process improvements, willing to take on more credit risk – presumably it would also be return-enhancing, so how much scope do you think there is to exceed that 5.5% return on risk weighteds by 2016?

John Flint

So three questions. Wealth – why do we think that we can be successful? Well, we currently generate substantial revenues out of wealth and we've only just started to get to the point when we have a stable wealth platform. When I talk about stability I am talking about technology, but also in terms of RMs. We've had significant deliberate movement at our instigation across the RM platform and anyone running a retail business will tell you that's one of the worst things you can do to a customer base – to start moving their RMs around. But we're now reaching stability because we've also managed through the change in the incentive framework, so I think we start 2014 in a fundamentally different place to 2013.

I think it's also the case that the goodwill of customers towards this organisation remains exceptionally strong. What our experience shows us is once you get organised you've got a product offering delivered through well-qualified RMs, and Hong Kong's probably the best example of this where it works. Clients are very happy to bring their wealth to us. The psychological break that sometimes exists that says, 'You're not a wealth brand; you won't be able to do it' – in the retail space our experience is telling us that once you've got a stable RM platform and decent technology you can do this.

I think it's fair to note though the challenge is different by market. I have higher degrees of confidence around our ability to execute wealth in some markets than others. I will accept that as a challenge, but that's why we're optimistic. What's different about us? Right now in the retail space, our incentive framework is fundamentally different. Nearly everybody else is still, I think, conflicting their staff when they come into work every day. They're still paying them – you know, points mean prizes or points mean bonuses, and I think everybody else needs to get off that. Getting off it's hard, and I'll tell you that because we did it this year – it had an impact on our numbers – but I think for us that's behind us. That's why we're different.

The return thing – your construct, the analytic you talked through on building up the returns I think makes sense. I'm glad you asked the question because it allows me to just highlight another issue for the retail business. We are de-risking. We are trying to improve the quality of revenues that we generate. If we look at the revenue growth that we'll produce this year, that revenue growth is net of having given up deliberately some revenues because we think they're low quality revenues or revenues that might become next year's redress. You know, you can create a scenario where you say, well, you're successful in wealth and rates go up, and redress comes off and then you end up with this ROE in the 40% range, and actually I don't think that will eventualise because there is a fundamental challenge to retail banking in the developed world already, and I think it's coming in to the emerging world as well around this conduct risk agenda that is challenging what you sell, how you sell it and the value exchange – the price at which you sell it. So I think this will continue to be a very high-return business, but there are some headwinds as well, which will, I think, reduce the benefit of the three items that you outlined.

John Greene

John, if I could just add a point – so in terms of cost/income ratio, through September we were at 64% on a revenue base of $19 billion. Certainly an incremental $2 billion or $3 billion of wealth revenues would help this cost/income ratio, but in the context of HSBC RBWM it's a material piece, but it by itself is not going to drive the cost/income ratio, the transformation works that John talked about earlier, and the increase in overall lending should help that as well as the drive for more efficient organisation that we started a couple of years ago and progressed well through today.

Rohith Chandra-Rajan

Sure. The question on cost/income actually was more on the incremental $2 billion of revenues. Presumably there's some cost offset to that and would it be around 50%?

John Greene

Yes, it would be accretive to the 64%.

John Flint

I think we've got time for one more question.

Mike Trippett, Numis

John, good morning. Three quick questions, actually, all very much on the conduct and regulation areas. Just a broader-brush question, firstly: the point you're making about conduct – do you sense that regulators, both the FCA here and overseas, are beginning to take a more engaged or constructive look to provide you with a guidance on what is acceptable behaviour or do you think the risk of retrospective mis-selling fines continues? Secondly, just specifically on the UK I just wondered if you could update as at Q3 where we are in terms of undrawn provisions on PPI, just what the state of play is there. Then just thirdly, you talked about some risks around regulatory treatment. I don't know if you meant the broader PRA risk or whether you're talking about mortgage floors as we've seen with the HKMA earlier this year.

John Flint

Sure, thank you. The first question was conduct risk and what are we seeing from regulators? I think I would say that we're not seeing a significant change in attitude yet. I still think that there is risk, particularly in the UK, of further retrospective views of the world. I think for now I think we look forward to a period where that might happen, where the attitude changes, but for now it would be too early to signal that that's what we're experiencing. We have a very constructive dialogue, but the experience remains that there is still a willingness to change standards and then to look back and to see certain circumstances redressed. I can't be optimistic on that one at this stage, I'm afraid.

I'll come back to the third question and then John will help me answer on the PPI. When I talked about regulatory capital treatment when we were talking about the return target, in my mind – I should have clarified that – I was talking about mortgages specifically rather than the Group's targets set by the PRA. Yes, recognising that some regulators are beginning to get a little bit nervous about lack of bad credit history in some markets – i.e. extremely good credit performance and very low levels of capital held against it. As you say, Hong Kong introduced a floor on new production. I think we need to keep an eye out for more actions like that across the portfolio. That's what I had in mind.

John, on the PPI, do you want to just give the update?

John Greene

Certainly. In terms of PPI there was a provision in the third quarter – a top-up of the provision. We don't see anything dramatic changing in terms of PPI, in terms of our outlook going forward. Certainly we're going to continue to review the provision levels and ensure they're adequate. We've taken cumulative provisions since the judicial review started of about $2.9 billion and to date we've paid nearly $2 billion and we'll continue to assess it. We're right in the strike zone versus competitors, so we're going to continue to watch it.

John Flint

Okay, everybody, thank you very much for spending the time with us today – much appreciated. I think that closes the call. Thank you all.

Footnotes

[1] Refer to page 170 of the Interim Report 2013. The interest rate sensitivities mentioned above are indicative and based on simplified scenarios. The limitations of this analysis are discussed in the Appendix to Risk on page 269 of the Annual Report and Accounts 2012.