4Q 2019 Post Results Equity Analysts Meeting

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HSBC

Ewen Stevenson, Group Chief Financial Officer: So I guess you all know the IR team, but a few other faces on our side. Tony Bloomfield here is Acting Group Chief Accounting Officer. Down the far end, I thought it would be helpful in the context of some of the discussion we were having around capital yesterday to have a couple of our resident experts here so you can fire some questions early on. Raf Hussain is Head of Planning and Stress Testing. Raf used to run stress testing with me at RBS and then went off to set up a stress testing advisory group for PwC, and joined us about six months ago. Down the far end, Richard Boyns is responsible for Group Capital Management. He lives and breathes the complexity of trying to manage the Group's capital position across multiple subsidiaries across the planet. I thought it would be helpful to have the two of them in the room if you want to get into detail on some of the complexity that we're working through, and the discussion between where we are in the range of 14-15%, and what drives you to one end or the other end of that spectrum.

The other thing – I guess I've been told that I have to clarify my comments around the Q1 impact of the coronavirus. What I thought I said, and what I was planning to say, was that if it was to be contained by the end of Q1, the P&L impact, rather than the revenue impact, would be in the order of $200-500 million. I think some people had heard revenue impact rather than P&L impact. A decent chunk of that will be in forward economic guidance adjustments to provisioning. There will be some revenue impacts, but as I said yesterday HIBOR continues to be higher than our planning assumptions, which is providing some offset. I think by the time we get to the end of April and we're standing up for Q1 results, if we're still in the middle of the coronavirus then we'll be able to give you a much fuller update, I think, on impacts, because some of it is still modelling through, for example the impact on global supply chains, and I think the longer this carries on the more the impacts will be felt beyond the immediate areas, single cruise ships, Hong Kong and China.

Martin Leitgeb, Goldman Sachs: If I could just have two, and the first one again coming back to the redeployment of capital and the redeployment of the $100 billion. Obviously, the $100 billion, a comparatively large number if you compare it on a $750 billion base, in particular, some of the language was the focus of the $100 billion might be more on the retail side and in retail capital. I was wondering how confident are you that this deployment can be achieved in the environment, or could there be a phase that actually the Core Tier 1 ratio might edge higher than your 14 15% and then in that case is the suspension of the buyback definite for 2020/2021, or could there be a scenario, for whatever reason, growth isn't as expected, that you would return capital earlier?

My second question was just on the rate sensitivity, and noting your assumption in terms of global interest rates from here. If you just update us on the sensitivity rates. If they're 25 bps higher, what would the impact be on earnings?

Ewen Stevenson: On the sensitivity, it is fully set out in the Annual Report and Accounts. We've got 25 basis points sensitivity, we've got 100 basis points sensitivity, we've got one-year sensitivity across different currencies. Richard can dig the numbers out. On growth, the –as I said yesterday, $100 billion effectively is slightly more than 4%, slightly less than 5%, compound growth on $750 billion of RWAs. That is the inherent run rate that we've been running at as an organisation for several years, and we've actually been constraining, in some areas, our growth rate. We're really – I don't think adding $100 billion of risk-weighted assets through natural growth with our business and where we're positioned is particularly difficult for us. If we left you with the impression that it's all driven by RBWM, we shouldn't have left you with that impression. There is a decent amount coming through Commercial Banking. Some of it's actually coming through Global Banking and Markets as well, in terms of repositioning more of its business to the emerging markets. We really don't think that a 4-5% underlying growth rate in RWAs is particularly challenging to us, given the markets which we're exposed to.

Richard O'Connor: I'll just give some examples. Last year – I'll just use customer lending. Asia grew 6%, the ring-fenced bank was 8.5% – that was, of course, mortgage and commercial – and in Mexico it was up 14%. That's just on the 7% growth last year, which wasn't a banner year for growth in those regions, by any means. If you go back two or three years before that, that's the typical growth rate as well in those other regions where we're redeploying capital. As Ewen said, we think it's a reasonable set of assumptions.

Ewen Stevenson: And then you'd have to – just say we're horribly wrong on that, what would drive us being horribly wrong? You would have to have a very different set of macro forecasts, I think. But then you would probably get an offset, because you would have RWA inflation from credit rating migration, which isn't necessarily a good scenario but that doesn't drive you to saying that there would be buyback capacity created because growth has suddenly cut off globally, because the scenario where you're not going to have growth globally is a scenario where you're probably going to have RWA migration.

Richard O'Connor: The rate sensitivity – it's in the Report and Accounts; it's also on our appendix slide 28. It's all there. It's similar to the previous year; it's about $2.8 billion up for 100 basis points, so it hasn't particularly moved year on year.

Ewen Stevenson: If we go back to one of the things I was saying yesterday, why did we stand up with a new plan yesterday, having just stood up with one in mid-2018? It's because when the plan was put together in mid-2018 – the principal thing that's changed is the outlook for global interest rates. We're a very interest rate sensitive stock, more so than most of our global peers, because the Hong Kong business reprices monthly, largely, and even on the Commercial book a decent chunk of that is quite short-dated, being trade business. What we see, with our interest rate sensitivity, is shifts in the interest rate translates very, very quickly to shifts in P&L, and we were probably sitting 150, 200 basis points off on what our interest rate assumptions were for this year, relative to when we set that plan in May. This plan has to – must, by necessity, be based on a greater degree of cost-cutting than would have been in the previous plan.

Claire Kane, Credit Suisse: Just a follow-up on the redeployment point. If you look at year-on-year this year, I know the Group's down in RWAs, but RBWM RWAs are only up $7 billion; that involves $34 billion of loan growth. In Asia it's only $2 billion up in the context there. I guess what I would like to try better to understand is really, if you think of the other areas of the business, you must be quite confident on the absolute lending growth that you can maintain, particularly in Asia and Retail. In GB&M, I guess most of the growth – say, $70 billion of de-leveraging RWAs saved must be coming from there, but on your expectation, that when you're at $850 billion in 2022, it's a net reduction of about $45 billion of RWAs. How do we think about the loan book in GB&M? Do you see a big change in credit versus market risk mix there, so you've got a $246 billion GB&M loan book? How will that change over that period?

Ewen Stevenson: I think it is more of a geographic shift than a business mix shift you see underlying those numbers.

Richard O'Connor: For both Banking and Markets for GB&M it's broadly equal. There's reduction between the two, and you've got RWAs. Clearly on leverage capacity it's more in Markets, $[50] billion gross, mainly in the non-ring fenced bank, for obvious reasons, with some growth in Asia. We reinvested in Asia, given the prime business. On RWAs, it's pretty 50/50 Banking and Markets, then on leverage it's clearly more concentrated in Markets activities, in derivatives in Europe. You would expect a net reduction in the GB&M Banking and loan book, but I think you would see growth in Asia and the Middle East, but more of a reduction in Europe, and to some extent the United States as well, if you look at the next two or three years.

Claire Kane: Should we expect a lower reduction in the loan book than 45% of the RWA takeout?

Ewen Stevenson: Yes. Yes is the answer to that.

Raul Sinha, JP Morgan: Maybe just to follow up on that, and then another question on NIM after as well. Is it because the Q4 RWA numbers of the bank was probably slightly below where it is on a look-through basis? You've got the $10 billion of RWAs and the seasonality within GB&M, which is probably understated the RWA number.

Ewen Stevenson: Everyone knows that year-end balance sheets are compressed down. In all of your own parent organisations, the same phenomenon exists. I don't think the core restructuring that was done in GB&M in Q4 is reversible. But if you look at the RWAs allocated to Balance Sheet Management, it was probably well below trend at end of year, so probably some of the growth we will see in Q1 is a bounceback, and RWAs within Balance Sheet Management. The other growth that's really coming through, Retail Banking and Commercial, and there's about $8-10 billion of regulatory outputs that we expect in Q1.

Raul Sinha: If we try to work through the net position on RWAs, by the end of 2020 –

Ewen Stevenson: Broadly – I don't have the numbers to hand, Richard, but I think broadly just stays flat for the next three years.

Raul Sinha: Because you've got a few uplifts coming from regulatory changes in this year. I guess you're offsetting that through the reduction, when you say 35% of the $100 billion comes in this year, and that's basically offsetting those as well as –

Ewen Stevenson: Look, on some of the RWA run down we can obviously manage, right? We can manage the timing of that. We can go to Markets and say, 'Speed up. Slow down.' Some of it is purely a question of economic cost– if you take the structured derivative book, for example – and you'll all have this on your own balance sheets – a lot of long-dated – the average duration of some of the interest rate swaps is 10 years. The P&L gets booked up front for accounting purposes. You're sitting on the economic loss, and it's just a question of price and when you crystallise that loss.

Raul Sinha: Can I ask why the long-dated swap book is still – is it still a material part of the GB&M balance sheet? Because most of the –

Ewen Stevenson: No, it's, probably, for us, about $6 billion of RWAs.

Richard O'Connor: Our forecast this year is slightly up at year-end because some of the reductions will be second-half-weighted and start to work through the programme, so it will kick in more in 2021/22, but it's not a big number in terms of the growth.

Raul Sinha: And then on the NIM, if I look, at the HBAP NIM in Q4, this is down five basis points while HIBOR was still quite high. Can you talk through a little bit of what's driving that?

Ewen Stevenson: Remember that the Hong Kong book isn't just Hong Kong dollar. There's also a decent chunk of US dollars in there, so it was some impact of the lower dollar rates, and also there was some margin compression on the asset side. Ming, do you want to give more colour?

Ming Lau, Chief Financial Officer, Asia Pacific: That impact, the five basis points reduction, was actually less than we had projected. We actually anticipated about 10 basis points. I think, as Ewen alluded to, what you have to remember is in the Asia portfolio there is a pretty significant amount of US dollar lending and US dollar deposits. As the rate cuts happened with the Fed, there were three rate cuts in 2019, so the impact of that is really feeding through the portfolio. As Ewen alluded to, because HIBOR rates over the last quarter was elevated, that helped to mitigate the anticipated margin compression. Five basis points were only about half of what we expected on margin compression. Heading into the first quarter, the rates on HIBOR remained elevated, but what I do need to caution is if you look at what's happened in the last couple of weeks, in February, the one-month HIBOR rate has started to come off about 25-30 basis points, at this point.

Raul Sinha: Could I ask, what proportion of the HBAP balance sheet is US dollars?

Richard O'Connor: Let me answer another way for you, because we've not disclosed. If you look at the system in Hong Kong. Just over 50% is Hong Kong dollar, and the majority of the rest is US dollar. Given our size in Hong Kong, you would expect us not to deviate too much from those averages. And then you can work out the rest of the Asia book: it's predominantly local currency and US dollar.

Mark Phin, Head Of Investor Relations, Asia Pacific: There's a breakdown of the loans and deposits by currency in the annual report. I don't have the page number but I can send that through to you afterwards.

James Invine, Societe Generale: Morning. $100 billion you're managing down, the clients who are on the other side of that, how much revenue and risk weighted assets do they account for in the rest of the Group?

Ewen Stevenson: Well, that's contained within the $2.5 billion number that we said would be the impact for GB&M as to the run-off.

James Invine: So that's total revenue?

Ewen Stevenson: Yes.

James Invine: Not just specifically to the bad products you want to get rid of?

Ewen Stevenson: No.

Richard O'Connor: The corporate relationships, etc. A lot of this is corporate relationships which don't hurdle our required return and/or are primarily domestic in nature. Those clearly take some time to work through, so it's not like they're going to come off in Q1 or Q2. That's be a one, two, three-year exercise on those corporate relationships. Many of them we'll be able to price up as well. That's our experience in the past.

Rohith Chandra-Rajan, Bank Of America: Looking at the revenue walk on slide 30. There's quite a chunky uplift from the, I guess, non-RWA-intensive businesses. I know you told us not to get our rulers out, but it looks like it may be $3-4 billion. If I think of the non-GB&M, non-interest income that was about $12 billion last year, you're looking at a 25-35% uplift. Just wonder if you can talk a little bit more about if those other numbers are broadly right, and where that uplift is coming from.

Richard O'Connor: We wouldn't comment on your numbers, but we're not disagreeing with them. A big chunk is actually in GB&M. We didn't have a great year in Markets last year. The FX franchise has grown and is growing quite well, but obviously with very low volatility. A non-repeat of some emerging market gains the prior year, so we do expect growth in some of those markets, like particularly FX and then the bulk – the majority's in the Wealth business, which had a good year last year, and we think – look at Wealth in Asia, it's still compounding at about 10% per annum.

Ewen Stevenson: And we've been investing heavily in supporting that growth.

Richard O'Connor: It's a combination of those two in the main.

Rohith Chandra-Rajan: On the US business, which is quite a contributor to the planned ROE uplift of the Group, the 10-15% cost cuts look like they might add 30 basis points or something to group ROE, so where's the revenue uplift coming from? You're shifting assets out of GB&M into the – I guess, primarily into CMB. Is that materially a higher return on risk-weighted assets business?

Ewen Stevenson: Yes.

Richard O'Connor: CMB in the United States is not there yet, but it's a profitable business, and it's grown quite nicely and it can do more there. On the Retail side, we do expect to bulk up on the lending side. It's not going to move particularly in your model, but it will obviously help in terms of the revenue, so we're growing in cards quite nicely, for example, in the last year or two.

Ewen Stevenson: There's also quite a significant capital efficiency plan too.

Richard O'Connor: It's a combination.

Alvaro Serrano Saenz De Tejada, Morgan Stanley: Ewen, following up on that capital efficiency, yesterday I think you said that the – a lot of the regulatory headwinds will be pretty much neutralised with capital efficiency. Can you maybe talk us through some of those efficiency programmes? Presumably there'll be more changes; de-leveraging will affect that, and also some of the changes in how you do business. Maybe you can walk us through some of those efficiencies and what are the risks of maybe there's delays to that. Will there be some differences year on year in terms of those headwinds versus efficiencies.

Richard O'Connor: Let's go to Richard Boyns to talk a little bit about the capital planning and the capital efficiency programme that we're working through.

Richard Boyns, Head of Capital Management: If you're referring to the capital plan efficiencies that Ewen mentioned on the call yesterday in respect of the complex structure of the Group and the multiple jurisdictions in which we operate, then there's really three sources of those inefficiencies. First of all there are some entities that have some – sometimes referred to as trapped capital – I don't like the term – but more CET1, for example, than one might anticipate given the RWAs within those entities, either because they have to fund broader capital requirements with CET1 or because they're constrained by something that's not RWAs. It might be a leverage constraint, for example, some pieces like that. More broadly, on the RWA side, the aggregate of local RWAs tends to be higher than the PRA RWAs. That causes a level of inefficiency, either for modelling reasons, because there are standardised approaches adopted in various jurisdictions, or because they're having to take RWAs against things that we don't at Group level, so inter-company transactions. The third area is there's a level of diversification benefit you get as you go up the Group, so you hold less RWAs against market risk, you get diversification against that, and so on and so forth.

Those are the key sources of inefficiency within the Group. As we work on those inefficiencies, essentially we seek to address those items. We look for areas where we can improve the capital mix, where regulation might evolve to allow us to issue AT1 and Tier 2 where we can't currently, for example. We look to see where there are opportunities to even out the constraints. If it's leverage constrained, we can transfer some of the assets that cause that to an alternative jurisdiction that's not leverage constrained so we can generate some capital efficiency. Look at the business model and some of the ways some of the inter-company works. Look at the local RWAs and what drives those, and indeed what drives local capital requirements more broadly versus what drives PRA requirements, and so on and so forth.

When we talk about dealing with these inefficiencies over a period of time, over the medium term, those are the sorts of things we're looking at in order to try and improve that position. Within that is stress testing, which I think Ewen mentioned yesterday. If one can manage the stress profile of entities, then one can reduce their overall capital requirements.

Richard O'Connor: I'll give you an example. The United States averaged about $90-100 billion of RWAs in the last few years, got $18 billion of capital in it because the local requirements are higher than PRA requirements. If we were to move more to the PRA requirements by, for example, moving assets over, you can sort of see there's a multi-billion dollar opportunity to get more capital out of the United States to the holding company. Then it's available for distribution or re-investment. That's just one example, and that's probably the most live example, because obviously you can see the US filings, you can see the US CCAR process, and we've been successful in that process over the last few years. We need to carry on doing that over the next few years.

Claire Kane: Can I have a follow-up on that point? I think on the half-year the US holding company had about $40 billion difference in RWAs. How much of that $40 billion can you get down, and is that the majority of the $25 billion efficiency save for the Group?

Richard Boyns: I think the key in the US, because of CCAR, is to manage the stress profile. Without going into too much detail, the plan for the US business envisages the management of that business in such a way as to release further capital from the US over time.

Claire Kane: Are you going to change the structure of the Group holding company issuing all the MREL debt and then transitioning that down?

Richard Boyns: No. That's a regulatory requirement that we adopt that approach. That's what the Bank of England says, and that will continue.

Richard O'Connor: What we said at the fixed income call is that we're broadly where we need to be on MREL, and broadly from here we plan to issue to match the maturities of the MREL stack over the next few years.

Ewen Stevenson: Broadly, if you look at where the Group is today, and based on the current stress characteristics of the Group, we would be comfortable operating the Group at the low end of the 14-15% range. By the time you overlay the capital inefficiencies of the Group, that pushes you to the higher end of the range, so we either have to lower the stress on the organisation so that we can be comfortable operating the Group within a tighter band of stress, and/or manage some of the capital inefficiencies. We know what we have to do. We haven't got it in the plan currently, but we do have confidence over the next three years or so that we should be able to significantly improve the capital efficiency of the Group.

Claire Kane: How much of that stress taking out GB&M assets from the US is offset then by an increase in your consumer credit exposure? Surely that performs badly in a stress too.

Raf Hussain, Head Of Planning And Stess Testing: That's a good question. I think if you reduce GB&M assets, and we're also calling these low-returning assets, and put them into other franchises and businesses, we would expect to see, all else being equal, increased revenue which will be, if you like, the first line of defence against losses and stresses, so therefore we should see better stress resilience. Most of these other businesses tend to have lower risk-weight assets, particularly in a consumer business in comparison to Markets. Net/net we're getting a better stress outcome because of better revenues, associated with new growth, new lending and lower RWAs associated with those assets.

Jenny Cook, Exane BNP Paribas: I just wanted to follow up on that question, around the internal stress testing, and get a sense on where you set the goalposts for it. Has that moved year over year, reflecting what's happening in Hong Kong? Secondly, I just wanted to ask on Basel IV. I appreciate you've been very candid in giving us the impact in 2022. If I look at the Report and Accounts, it suggests that the pre-mitigation impact was a lot higher, around 5-10%. If you could talk us through the drivers, in terms of where we've gone pre to post, that would be quite useful. Thanks.

Raf Hussain: I'll take the first question, then. In internal stress test, we look at a number of scenarios of varying degrees of severity, focusing on different vulnerabilities that we're facing. Given our geographic footprint, we tend to look at global scenarios that are calibrated to somewhat similar severity to what we run on the regulatory ACS or some CCAR-type stress tests that we run that are quite extreme scenarios. We tend to model them to have synchronised downturns, with large asset price falls, trading market shocks and other sources of risks like high rates or low-rate environment. We'll look at those as well. We also look at different shapes. With the regulatory stress test, we tend to see instantaneous shock. With our internal stress test we're looking at different profiles and different pace of recovery in those stress tests as well in those scenarios, which will obviously impact our profitability and capital ratio profile.

Ewen Stevenson: We are behind others, currently, in terms of fully embedding stress testing into BAU management practice. Partly, I think it goes back to the history of the organisation. We didn't need capital support from government as part of the financial crisis, so those organisations that did, I think RBS being a good example, massively invested in stress testing, recovery and resolution planning, because they needed to. It was just less of a priority here. I do think there's a massive opportunity as we scale up our capabilities.

Raf Hussain: Just to add, that will help with the capital efficiency question we had earlier on. The more stress tests we run, the more we embed it within our BAU planning, we should be able to improve the risk profile and therefore the resilience of the balance sheet.

Richard O'Connor: On Basel III revisions, I'll kick off. The 5 10% range is right. It's nearer the low end of that range as we work through it. The majority of it will be CVA mitigation and some operating risk. A big chunk of this plan, in terms of the reduction in GB&M leveraged assets, will obviously help that Basel III mitigation over the next two, three years.

Ewen Stevenson: I'd also say from a timing perspective, we're still working with planning assumptions on the basis of the current timetable, which is 1 January 2022.

Jenny Cook: That still assumes FRTB in 2022.

Ewen Stevenson: But all of us have a high suspicion that that timetable will slip, which would only benefit us. This plan assumes that we have to be Basel compliant by the end of 2021.

Ben Toms, RBC: On CRR2, and the potential benefit from switching – from being able to use software intangibles in your capital, is that included in the plan, or is that a potential benefit – upside to the plan?

Richard O'Connor: Not assumed.

Ben Toms: Can you give a number what the potential benefit could be, or is that still too unknown?

Richard O'Connor: About 50 bps, if it were to happen, but don't assume it will happen in the UK.

Ben Toms: Then secondly, on – in the UK on branch reductions, does the plan include acceleration of branch reductions, or does it assume a natural attrition in the UK?

Ewen Stevenson: I don't think we're going to publicly talk about branch plans here on a call. What we said yesterday was we will respond to customer preferences. Customer preferences are increasingly digital. We constantly review the size and number of branches that we have, including in the UK, which is far more digital than most economies, in terms of the acceleration of that switch. Having said that, there's a whole bunch of social and political considerations that also drives our approach to branch infrastructure in the UK. You should assume that over time we should be able to – and will, as more and more customers become digital – either reduce the size of our branch footprint – but that doesn't necessarily mean closing branches. It may just mean smaller branches. All of that will be built into the plan. There are no current public announcements around further branch closures in the UK. The only announcement we went public with yesterday was saying that we expect a 30% net reduction in the US.

Richard O'Connor: The ring-fenced bank plan is very much BAU. Clearly the whole Group has got to be more efficient, including the ring-fenced bank, but there's no – there's nothing flagged yesterday outside of BAU for that bank.

Matt Clark, Mediobanca: Could you talk a bit about the US footprint and what the critical factors were that led to your decision to downsize but retain the Retail, and move other bits about? What, in terms of infrastructure, balances, critical mass, were the pointers or metrics, parameters, I guess, that led you to that decision, and what is the optimal US presence for you going forward?

Ewen Stevenson: To reiterate I think what Noel said a few times yesterday, the US remains important to us. We're a big dollar clearer; we've got a big US Commercial business that is very focused on what we consider to be our sweet spot of international trade, both inwards and outwards. On the Retail side, we think we have core competitive advantage in the diaspora, particularly Chinese diaspora, but over time, given our business in Mexico and India, we should be able to build a better diaspora business for both Mexicans and Indians in the US. If you look at the underlying economics of that customer segment, international diaspora, it's a multiple of normal retail business economics.

For us, therefore, where to service that customer base is more west coast than east coast. If you look at our current distribution network, I think we have something like five times the number of branches on the east coast than we do on the west coast. At the end of this plan, it's one to two rather than one to five. That involves a more significant reduction than 30%; it's about a 50% reduction in the east coast branch network and a 25% increase, I think it is, on the west coast branch infrastructure.

The other thing, we sold our consumer business in the US a few years ago. The predominance of economics in US retail banking is in consumer banking, so we do need to build back a presence in consumer banking in the US, selectively, to increase the economics of our Retail business. It lost close to $300 million pre-tax last year. To get back to the sort of returns that we need to get back to, we need to see it making a couple of hundred million dollars, and we think we've got a plan that can do that over the next few years, but realistically it will take five years to get to that place. Certainly, we should be able to get business back to break-even in three years.

Again, if you go back to June 2018 when we set out the original plan to get the US to a 6% RoTE, that was very much based on a very different outlook for US rates than what we now see, coupled with, effectively, significant revenue and volume growth, to take advantage of that different rate environment. This plan I think is premised on far lower growth and a meaningful cost reduction.

Matt Clark: It sounds as if it's about optimising the value of the US Retail business, specifically, rather than any particular tie-in to the rest of the Group.

Ewen Stevenson: The US Retail business is a core source of core funding to the US bank. So we're not just running a retail business in the US because we like running a retail bank in the US. You've always got to go back to the individual legal entities and say, 'What makes a cogent business for that legal entity in the country?' One of the issues with our business plan is we can say, 'Our core business plan is to do x,' but the reality is in many markets we need to do an element of domestic business in order to create a viable business in that legal entity. It's not dissimilar in the US. We need a retail business in order to run commercial business, or we would have to come up with a radically different sized US commercial bank with a radically different approach to funding that business.

Aman Rakkar, Barclays: Can I just follow up on that? If you look at the net interest margin in the US business, it's pretty low. It's been falling.

Ewen Stevenson: That's because we're not big in consumer, which is where…

Aman Rakkar: Just to be clear on that, then, it's not driven by lending growth and it sounds like it's a kind of re-risking of that business. It sounds like it's unsecured consumer credit in the US. Is that the right inference?

Ewen Stevenson: No, we're over-invested in domestic business in the US, so just shifting from domestic to an international focus improves the margins that we're hoping to get. There is a re-weighting in consumer as part of that. Running down the GB&M business I think is a low NIM business in some of that, so all of that together should materially improve the net interest margin in the US.

Aman Rakkar: It's kind of replacing the revenue returns of that rather than… Just got a couple more. I should probably know the answer to this, but I don't. On Basel IV, the output floor, credit risk outlook, does it apply at the HSBC Group Holdings level, or does it apply at the local entity level that kind of aggregates up?

Richard Boyns: We don't know, is the answer. It will apply at Group level. We don't know what levels within the Group it will apply to yet.

Ewen Stevenson: But we have done modelling on that. We don't think the output floor creates any material issue for us until 2027, when it's fully implemented, and we do think by the time we get there we will have had time to optimise for it.

Aman Rakkar: I presume there's got to be a high degree of estimation risk on that though, because they could give you –

Ewen Stevenson: Of course, but equally we can run the modelling at a local legal entity level at the moment and we know where the hotspots will be. We've got the ability to shift assets in and out of entities, and increase or decrease the level of risk-weighted asset density that they have in them. Yeah, we've got plenty of time to plan for this and we don't, as I say, currently see it at a – there's some impact in 2026, and more meaningful impact in 2027, but we do think it's far enough out that we'll have plenty of time to optimise for it.

Richard O'Connor: To give you an example, UK mortgages, clearly low risk-weighted, as you'll know. You have optionality there in terms of covered bonds and RMBS, for example. Those are just two programmes which we're looking at. That's just one example in the Group.

Aman Rakkar: I guess just the remark is it is remarkable how low the Basel IV impact is on – if it's going to impact a business I'd imagine it to impact a business like HSBC, given the various global businesses, and for you effectively to call this out as a low single digit impact on your business is – I guess you've been clear about the reasons for that, but it is quite – it's a remarkable thing, and I guess I'm just trying to interrogate, basically, is it beyond the forecast horizon that there is some to come?

Just a point – final question was just on Asia. I know the prior strategy that John [Flint] laid out talked about things such as entering certain greenfield markets. I think they were talking about Australia mortgages were something you guys were under-represented in, or unsecured consumer credit in certain parts of Asia. My sense from Noel yesterday is perhaps that's not something you guys will look to pursue now because, even though they might be higher ROE products in themselves, they don't fit within the cross-sale and wealth and personal proposition more broadly. Is that fair or…

Ewen Stevenson: No, I wouldn't read that into Noel's comments yesterday. We do think, for example on things like Australian mortgages, there's still a very deep linkage of that mortgage business into our focus on international customers. The primary strategy in Australia is not to be a domestic bank in Australia.

Richard O'Connor: A lot of the assumed growth in RWAs in Asia over the next few years is in the Commercial Banking business and, to a lesser extent, the GB&M business, as we shift more assets into that region, and there's more cross-border flows, more investment, more green finance. All those still very much apply. As you saw, our Asia loan growth last year is 6%, although it's quite slow and sluggish in recent months

Ewen Stevenson: And in some markets the consumer finance strategy is very linked to the retail strategy and customer acquisition strategy for Wealth. I think it probably more reflects Noel's bias, given his background in commercial. If Charlie [Nunn] had been standing up he would talk eloquently about all of that.

Guy Stebbings, Exane BNP Paribas: Can I talk about the UK strategy? As the risk weights on mortgages go up at the end of this year, given some margin pressures in the UK, at the same time you've reviewed the economic outlook in the UK. Does that change your views at all in terms of where to allocate capital in growth for the UK? Should we see more growth in some of the other asset classes, or just assume for now similar to what we've seen the last couple of years?

Ewen Stevenson: Even with much higher risk weights in the UK, UK mortgage business is still attractive for us to write. We think we're underweight UK. As I said yesterday, we have 13-14% share of current accounts by value. We have about 10% on consumer credit side, and we have less than 7% in mortgages. We just think there's a natural growth opportunity. Our funding costs – we're the best rated bank in the UK relative to our peer group, so our funding costs are typically cheaper and therefore our sweet spot is super prime mortgage lending in the UK, and we are competitive in that business. You can see that in the LTVs of our business relative to peers. We think it's good business and we think we're going to continue to be able to write business above our stock share.

Guy Stebbings: I just wondered whether you might sell some of the growth to higher risk weight areas. You mentioned the output floor is obviously a long way away. Obviously, that's one way to reduce the impact if the output floor doesn't –

Ewen Stevenson: Look, and it's not – if you take Brexit, we think we're well positioned for that, because UK corporates are going to fundamentally have to reposition themselves, given the impact of Brexit, and we're a bank that specialises in international trade, and we are the best trade bank in the UK. I wouldn't read into the comments on mortgages to say that we're ignoring the fact that we think there's a very strong opportunity for us, competitively, out of Brexit, as a result of the repositioning of UK trade, which is in our sweet spot.

Joe Dickerson, Jefferies: I just had a question – just a couple of things. One, just on the US, what is the link between the actual retail deposit base and the dollar clearing? There are other banks that don't have a branch presence. Even when you take out the retail piece, I think there's about an $18 billion excess based on the Q3 filings in the retail piece, and the Group has an AA rating. I guess I'm trying to square that circle. The aspiration of breaking even in three years is – it's a good place to get from where it's been, but how do the two link and how can you make this diaspora banking work? What would be the value proposition to those customers? That they can walk into an HSBC branch and then do business overseas, because that in the past, by personal experience, has –

Ewen Stevenson: It does work today. If you look at our Canadian business, for example, we probably have 15-20% share in the west coast of Canada because of Chinese diaspora. If you look in UAE, we've got well over 50% market share of expats in the UAE. The business model does work in various parts of the world. It, in the US, has become diluted on the retail side by an over-focus on domestic growth as opposed to international diaspora growth. We've got intergenerational relationships across the world with people who were brought up in Hong Kong, or with connections to Hong Kong. When the kids go overseas to study in the US, we fund their kids to go study in the US. We know the model works, and when we concentrate on that model it produces very good returns for us. The funding surplus is more to do with aspirations in commercial in the US, and funding of the commercial bank.

Joe Dickerson: Just on the – you mentioned the UK trade, and maybe it's a question for Hong Kong, or you can answer – I think the one thing that the coronavirus situation is going to make a lot of corporates do is think about diversifying their supply chain. Given your footprint, you're in a good position to help them achieve those goals. Are there any early signs that this is happening?

Ewen Stevenson: There's certainly – if you look at the US/China trade dispute, which has probably been running for longer, there has been a repositioning of supply chains and manufacturing capacity across Asia, and we've been well positioned for that reposition. The other thing I would say for trade is not to excessively focus on US/China too as part of this, because intra-Asian trade is a far bigger business for us than China/US trade, and the growth in intra-Asian trade – Ming or Kathleen, you may want add to this– but it's one of the dominant sources of trade growth for us.

Ming Lau: I would agree. I would say the intra-Asian trade growth is probably one of the fastest, if not the fastest, growing trade corridors globally. I guess, further to that question, in terms of that shift in manufacturing and supply chain, even before coronavirus and the trade war, that was happening anyway, particularly with the low value manufacturing. I think what you're seeing with the US/China trade war, it just pushed and accelerated that shift out of China. In reality, back to my point, that was happening anyway in terms of that shift. If you look at the growth across our Commercial Banking business and trade, we've been there to capture a significant part of that growth, and we are helping clients when they do want to move manufacturing facilities into other parts of Asia.

Ian Gordon, Investec: Sorry if it's dull, but can I ask a couple of questions on tax? Firstly, can you confirm your planning assumptions? Secondly, can you talk about any vulnerabilities you perceive and what, if any, actions you may take other than writing a cheque? I guess I've got three buckets of concern: US election risk, are you just assuming the status quo? In the UK obviously we've just elected the most left-wing government since the 70s, with a proven appetite for policy reversal and creative new taxation. Then, thirdly, anything in the rest of the world which you think is of interest?

Richard O'Connor: It's public in our assumptions that the underlyingrate is 19 to 20%, and reported rate is 24%, because clearly some of the restructuring is in the UK, and so we're not assuming the UK DTA. That's just one example, but that's our plan assumption. It doesn't assume any changes to existing rates in Hong Kong, or the UK, or the US, or any change in regime, or indeed any benefits from that.

Ewen Stevenson: We are assuming a benefit from the UK bank levy change.

Ian Gordon: You're assuming that deferred bribe for you to stay domiciled in the UK is safe.

Richard O'Connor: It'll go from the global to the UK balance sheet on 1.1.2021 from just under a billion to about $300 million.

Ian Gordon: Under current legislation?

Richard O'Connor: Under current legislation.

Ian Gordon: Apart from the – you're seeing the 17 goes back to 19 in the UK.

Richard O'Connor: Yes, absolutely.

Raul Sinha: I maybe have a couple of follow-ups on the $31.5 billion cost number. It's just a little bit confusing the way you said it, because 31 January the dollar rate was quite elevated compared to where we are today, and then, I guess, we have to think about how the mix of the FX structural exposure changes under this plan. Can you help us think about the how the sensitivity will change going forward?

Richard O'Connor: Yeah, we published that at the end of January. If the rate in January applied then income will be $0.5 billion higher pro forma and costs will be $0.5 billion higher pro forma. And so I think you should use that as base. It's clearly mainly the UK sensitivity at the moment.

Raul Sinha: It's basically the cable –

Richard O'Connor: That's the big one at the moment.

Raul Sinha: Doesn't that get less relevant for you going forward because of GB&M restructuring, or that – because GB&M in the UK is a high cost-income ratio business.

Richard O'Connor: That's logical, but clearly you're looking at distribution in GB&M from, call it 30 to under 25. As we said, there will be that gradual shift to do more dollar block assets in Asia and the Middle East, so that would be something which we'd clearly update you on at least once a year when we look at our FX plan and assumptions. I don't have any numbers to tell you over and above that at the moment.

Raul Sinha: Then then second question on the investment, especially the tech investment, how much of that are you assuming is capitalised?

Richard O'Connor: Just about 50. Just over. That's been consistent.

Raul Sinha: And that's in the capital planning assumption.

Richard O'Connor: Yes.

Raul Sinha: And you're not assuming that you get, obviously, the capital benefit.

Richard O'Connor: No.

Claire Kane: Just one quick one. On BoCom, the gap now – value-in-use gap – is one of the biggest it's been for a while, and given a lot of the assumptions are quite long-term, do you think there's any risk from coronavirus extension playing out having any impact on the assumption there? Just to clarify, on the accounting, is it just a case of P&L will impair out the quarterly earnings if it were to be impaired, but the capital generation continues to accrete?

Ewen Stevenson: There would have to be a change in approach to profile, which we don't currently plan on, in order to change the accounting policy, to change the approach. Just to go back, we hold about – we don't think we're misinforming the market. We hold about $10-11 billion in Core Tier 1 against the BoCom investment, and it's broadly – market value is equivalent to the amount of Core Tier 1 we hold against it. The value in use calculation, and the holding value is around $18 billion.

Claire Kane: I guess if you lost those earnings it would impact your RoTE, not the capital generation.

Ewen Stevenson: That's true, and we'll look at that in that context.

Tony Bloomfield, Interim Group Chief Accounting Officer: There would be an accounting impact, but to Ewen's point it doesn't impact capital. We'd have to impair quite a long way down before starting impacting capital. Yes, it would impact your reported RoTE, certainly, if we ended up impairing it. The point on coronavirus, it just all depends on, again, the earnings reported by BoCom, how we see the – I guess the long-term future and long-term assumptions. Obviously, at this stage there's no change in that. A lot, again, will depend on how what's going on at the moment carries on and any long-term effect. At the moment we don't see any change in our approach or impact.

Ewen Stevenson: You saw last year the associate contribution of BoCom went up. That was masked by Saudi British Bank down a bit, I think. Took some incremental provisions post the merger.

Ming Lau: I guess the only other point I would point out, in note 18 in the accounts, which is on page 285, the sensitivities on BoCom is laid out. Through year-end we have assessed the sensitivity on the value-in-use subsequent to the coronavirus. At this point, that $2.5 billion headroom, we're still comfortable, even with coronavirus happening at this point, that the asset's not materially impaired or changed in terms of that headroom we have.

Raul Sinha: One more follow up. HIBOR assumption, 130, obviously as you say, we are quite a long way away from that, but it looks like that's the year-end assumption. I was wondering if you could share with us what you average assumption is underpinning the $1.1 billion?

Richard O'Connor: We were sort of assuming a plan, a 25 bps reduction in, say, May in the US, and that would feed into HIBOR through the year, so that sort of gives you the planning assumption.

Raul Sinha: When you made the earlier comment that the HBAP margin obviously outperformed your own expectations in Q4. I guess what I'm trying to understand, obviously you pointed out the HIBOR is down. I'm trying to understand are you making that statement because you're assuming HIBOR to fall to 130, or you're just looking at what the actual rates have been in Q1?

Ming Lau: Yes, so when we did the forecast, the plan on the rate curve for Hong Kong dollar, we had assumed that Hong Kong dollar would move in parallel with US dollar. The assumption on one month HIBOR that we had in the forecast, average for 2020 was in the range of about 145 basis points. If you look at where one month HIBOR stays more in the range of about 175, this is about a 30 basis point gap today relative to what we had in the average yield curve for 2020 in the forecast.

Richard O'Connor: Pretty volatile, as you know.

Claire Kane: Just another follow-up on the margins. The $1.1 billion, you said the majority you think will be in 2020. How much do you think – because I know you give the year one, year two, year three – do you think it runs through, or are you hoping management and a change in repricing and things like that will offset later-year impact?

Richard O'Connor: We're assuming it's only – of the $1.1 billion it's only $200, $300 million that flows through to 2021, so the vast majority is this year, and then we're assuming it stabilises from there. That's our planning assumption.

Claire Kane: It's a bit theoretical, those year one, year two?

Richard O'Connor: Yes, absolutely. It obviously makes various pricing assumptions which we have to put through the model. And as you know, because of HIBOR we're much more sensitive to year noughts or year ones than other banks, because you don't hedge the HIBOR impact.

Joe Dickerson, Jefferies: If the direction of rates is not as you assume, so for instance if you see rates going up in the UK, would you use the benefit from that to accelerate the restructuring programme? In other words, if there was an extra billion or so freed up, would you accelerate the cost or would you just hold onto the difference?

Ewen Stevenson: I think on the cost programme we'll go as fast as we can. We were actually on a call, Kathleen and I, this morning talking about it, but yes, the plan is to go as fast as we can conceivably go with taking costs out of the organisation, so it's not like we're sitting on stuff and going to delay it if we think there's an opportunity to accelerate it. I think what probably would change is an approach to an investment in growth more than anything to do with the cost programme, so the problem for us with absolute cost numbers, or jaws or cost income ratios or anything is if you look at the – we've got the ability to flex growth and invest in growth, so if the interest rate assumptions are much better it gives us more capacity to invest, I think.

Richard O'Connor: You're right to think the UK is the most interest-rate-sensitive of our currencies at the moment, of $2.8 billion benefit to 100 bps, $1.1 billion in the UK.

Joe Dickerson: Yeah, it's nearly 100 basis points of ROE, but what consensus do you use? Is there a consensus of how those rates go down, or…?

Richard O'Connor: We use the rates as at the end of October, November, so clearly they've moved since then and it'll be pretty easy for you to flow that through your model, depending on your own assumptions.

Joe Dickerson: The consensus has them going up.

Ewen Stevenson: I think using a single point source of forecasting is wrong, right? We'll use the best source of consensus that we can come up with, because if you just go to a single source of economic forecasting I think that's more biased than using consensus, even with the floors that sit within a consensus forecast. I do think for your benefit it's a better basis of forecasting, and then if you want to overlay different assumptions on it we've given you the interest rate sensitivity and you can overlay your own different assumptions on it. But we have seen gaps, for example in the past, between what our own internal economics were forecasting where there's consensus, which we felt uncomfortable with from a financial modelling perspective at a Group level.

Raul Sinha: Can I ask one more follow-up on asset quality? The loan forbearance that you're currently doing in Hong Kong for the virus impact, and also maybe in China, can you talk about how that is accounted for? Is it a Stage 2 classification?

Ming Lau: On that it really depends on the specific asset class. On the Commercial side at this point we're not expecting any change on the staging for those clients who are receiving any benefits from those schemes. On the Retail side, on cards specifically, if there are any clients that are actually receiving any help on the credit card portfolio those would go into Stage 3. On the mortgages themselves, the mortgage programme works on that specifically. We'd expect those clients to move into Stage 2, albeit from an overall ECL or RWA perspective. We're not expecting any material impact from those on the retail side.

Richard O'Connor: So far it's in the tens of millions of dollars, so it's –

Raul Sinha: I think it's $3.9 billion before the programme.

Richard O'Connor: In terms of take-up there was more interest in the last week or so, but the actual take-up so far has been very, very low.

Ming Lau: Yeah, I mean, there's a lot of client interest, but in terms of the actual take up on those programmes at this point it's not an overly material number at this point.