Edited Transcript

1Q 2015 Earnings Release

Presentation to Investors and Analysts

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Corporate participants:
Stuart Gulliver, Group Chief Executive
Iain Mackay, Group Finance Director

HSBC

Stuart Gulliver, Group Chief Executive

Good evening from Hong Kong and welcome to our first-quarter results call for analysts and investors. With me today is Iain, who's going to talk through the detailed financial performance. We'll both then take questions, but let me start by pulling out a few highlights.

Reported profit before tax for the first quarter was $274 million higher than the first quarter of 2014, and adjusted profit before tax was up US$349 million. Global Banking and Markets had its usual strong start to the year, with an 8% revenue increase in the Markets business. Commercial Banking continued to perform well, particularly in the UK and Hong Kong, and principal Retail Banking & Wealth Management generated increased revenue. Loan impairment charges were significantly lower compared to the same period in 2014, particularly in Europe and in North America.

Adjusted operating expenses increased, as expected, and we continue to work on initiatives to deliver cost savings over the remainder of 2015 and beyond.

The results for the first quarter of '15 reflected a significant improvement on the last quarter of 2014, led by higher revenue in Global Banking and Markets. We generated $4.6 billion of capital from profit in the quarter. This enabled us to strengthen the core equity tier 1 ratio to 11.2% to fund the first interim dividend of 10 cents per ordinary share, which amounts to $1.6 billion net of planned scrip, and also to continue to support asset growth.

As you all know, we'll hold an investor update on 9 June, and I'm now going to hand over to Iain to go through the details of our performance.

Iain Mackay, Group Finance Director

Thanks, Stuart. For the first quarter, reported profit before tax was $7.1 billion, compared to $6.8 billion in the first quarter of last year. Adjusted profit before tax was $6.9 billion, compared to $6.5 billion. You will recall that the adjusted measure excludes the period-on-period effects of foreign currency translation differences and significant items. You'll find more detail on these adjustments in the appendix to the presentation.

Looking at some key metrics, the annualised reported return on average ordinary shareholders' equity was 11.5%. This is lower than the return on equity in 1Q14, primarily reflecting the impact of dividends payable on additional tier 1 capital which we issued in the third quarter of last year. The annualised reported return on average tangible equity was 13.1%. On an adjusted basis, we have negative jaws of 1.5%, in line with expectations for the first quarter, and our common equity tier 1 capital ratio on an end-point basis, was 11.2%.

This next slide shows the breakdown of profit before tax for the first quarter and the preceding four quarters. Adjusted profit before tax for the quarter increased by $349 million compared to the first quarter of 2014, driven by higher revenue and lower loan impairment charges, partly offset by higher operating expenses. As you can see in the top right of the slide, the increase in profit before tax was driven by Asia and Europe. Higher profits in Asia were driven by increased revenue in Hong Kong and mainland China. This reflected increased insurance revenue in Retail Banking and Wealth Management from life-insurance manufacturing, in part due to improved equity market performance and investment distribution. In addition, we saw increased revenue from average balance sheet growth in Commercial Banking and a favourable performance in our Markets businesses in Global Banking and Markets.

In Europe, revenue is up. This was driven primarily by Global Banking and Markets in the UK, with higher revenue and Balance Sheet Management and improved performances in our Markets businesses, along with improved loan impairment charges. In North America, profit before tax was lower, mainly in Global Banking and Markets, due to investment in growth initiatives and lower revenue, partly due to non-recurrence of a prior year gain on sale in Principal Investments. This was partly offset by higher profits in Retail Banking and Wealth Management in our CML portfolio. Here, the continued run-off led to a reduction in revenue which was more than offset by lower loan impairment charges and lower costs. As we go through the rest of the presentation, we'll talk to global business performance in more detail.

This slide shows an analysis of revenue. Revenue in principal Retail Banking and Wealth Management was $186 million higher. This was driven by higher revenues from Wealth Management products, notably in Asia, where higher life insurance revenue reflected an improved equity market performance and higher investment distribution. This was partly offset by reduced personal lending revenues, mainly due to a reduction in overdraft fees received in the UK. This reduction reflected the re-pricing of overdrafts and fewer overdrawn balances, following the creation of a new text service to alert customers when they go overdrawn. Commercial Banking revenue increased by $190 million, due to higher net interest income. This reflected average balance sheet growth and wider lending and deposit spreads in Hong Kong. The UK also continued to see balance sheet growth.

In Global Banking and Markets, excluding legacy credit, revenue increased by $436 million. This was driven mainly by Balance Sheet Management, partly due to increased gains on the disposal of our available for sale securities. Revenue was also higher due to increased volatility in Foreign Exchange and increased client flows in Credit and Equities. Credit also benefited from favourable movements in credit spreads. We recorded strong growth in Payments and Cash Management and Securities Services due to increased balances across the businesses. By contrast, Rates revenue decreased, reflecting difficult market conditions.

Global Private Banking attracted positive net new money of $3 billion in the first quarter of 2015 in areas that fit our desired model, over 40% of which came from collaboration with our global businesses. Global Private Banking revenue was broadly unchanged, as an increase in revenue from Asia more than offset a reduction in revenue caused by the continued repositioning of the business. Revenue in 1Q15 was up by $1.8 billion, or 13%, from the last quarter of 2014 as a result of an increase in revenue in Global Banking and Markets. Improved market conditions, together with seasonal factors, have benefited Foreign Exchange, Equities, Credit and Rates. 4Q14 was also adversely impacted by the introduction of the funding fair value adjustment on certain directive contracts.

This next slide shows the largely sustained growth in our customer lending over the past 12 months – a period in which we have continued to run off our CML portfolio. The figures shown on this slide are on a constant currency basis. It's worth nothing that, on a reported basis, loans and advances actually decreased by $18 billion during 1Q15. This reflected adverse foreign exchange movements of $35 billion, primarily sterling and the euro weakening against the US dollar. You may recall from the year-end that we have split our lending and customer accounts into 'red-inked' and other balances. Red-inked balances relate to corporate overdraft and deposit positions, where our clients benefit from net interest arrangements across these positions. We report these balances on a gross basis in our accounts. On a constant currency basis and excluding the effect of red-inked balances, lending increased by $16 billion since the start of the year, particularly in Global Banking and Markets and Commercial Banking in Europe and North America, and Retail Banking and Wealth Management in Hong Kong. Also, on a constant currency basis, customer accounts increased by $12 billion, particularly in Retail Banking and Wealth Management and Global Banking and Markets in North America and Asia, and Retail Banking and Wealth Management and Commercial Banking in Europe. We continue to have a strong leverage ratio, which now stands at 4.9%.

Adjusted operating expenses increased by $483 million compared to the first quarter of 2014. This was driven by higher staff costs and increased marketing spend. Some of the increase in staff costs was caused by further investment in growth. In the first quarter, we increased the number of customer-facing staff in Retail Banking and Wealth Management, particularly in Asia, and in Global Banking and Markets, particularly in Payments and Cash Management. Higher staff costs also reflected wage inflation in Asia and Latin America, and an increase in spending on Regulatory Programmes and Compliance. Marketing costs increased due to investment in marketing campaigns to support growth. In Retail Banking and Wealth Management, these included the Big Start initiatives and the re-launch of Advance in the UK and the US. Compared to the fourth quarter of 2014, you can see that the adjusted operating expenses have decreased by around $1.6 billion. The largest factor here is the UK bank levy of $1.1 billion, which we recorded in the fourth quarter. Since year-end, we have focused on developing and implementing streamlining plans to deliver net savings. We expect to begin seeing the benefits of these actions in the latter part of the year, and we'll provide further details at the investor update on 9 June in this regard.

Adjusted loan impairment charges were down by $136 million to $570 million in the first quarter. The ratio of loan impairment charges to average gross loans and advances to customers fell to 24 basis points from 31 in the first quarter of '14. This was mainly due to lower loan impairment charges in Europe and North America. In Europe, loan impairment charges fell by $85 million, most notably in Global Banking and Markets. This primarily reflected lower specific impairments in Capital Financing. North America was $92 million lower, reflecting reduced levels of new impaired loans and delinquency in the CML portfolio, as well as lower lending balances from the continued run-off and loan sales. This was partly offset by lower favourable market-value adjustments on underlying properties, as improvements in market conditions were less pronounced than in 1Q14. Compared to the fourth quarter of 2014, you can see that loan impairment charges were down by $584 million. This was mainly due to lower charges in Asia, Latin America and Europe. In Asia, this primarily reflected a small number of specific exposures in Hong Kong and mainland China, which resulted in higher charges in 4Q14. In Latin America, there were lower specific and collective impairments in Brazil in Commercial Banking in 1Q15. In Europe, there were collective impairment releases in 1Q15 in Global Banking and Markets and Commercial Banking, in contrast to the charges that we saw in the fourth quarter of last year. You'll note that our credit experience in Europe and Asia remains very stable.

This next slide shows our Group return metrics. The annualised reported return on average ordinary shareholders' equity was 11.5%. This was lower than the return on equity in 1Q14, primarily reflecting the impact of dividends payable on additional tier 1 capital which we issued in the third quarter of 2014. Adjusted return on risk-weighted assets was 2.3% in the first quarter of 2015, compared to 2.4% in 1Q14. Excluding run-off, adjusted return on risk-weighted assets is 2.4%, compared to 2.5% in 1Q14, reflecting an increase in risk-weighted assets. Average risk-weighted assets were higher due to the implementation of CRD IV in 2014, and loan growth in Europe, North America and Asia. The implementation of CRD IV was not fully reflected in the average risk-weighted asset calculation in 1Q14.

Turning to capital, the Group's end point Common Equity Tier 1 ratio at Q1 was 11.2%, against 11.1% at the end of 2014. This reflects positive Common Equity Tier 1 capital generation of $4.1 billion, this being profit attributable to shareholders net of regulatory adjustments and including the deduction of first interim dividend net of scrip. This also includes the benefit of a fourth interim dividend scrip take-up. After adjusting for the effects of foreign exchange translation differences, risk-weighted assets grew in the period, principally due to asset and market-risk position growth, offset by continued reductions in legacy positions and implementation of further risk-weighted asset management initiatives. The partial sale of our interest in Industrial Bank had no material impact on the Group capital ratio overall. In short, we have both maintained the dividend and grown the capital ratio in the quarter.

With that, let me hand back to Stuart.

Stuart Gulliver

So, we'll now take questions.

John-Paul Crutchley, UBS

Just a couple of quick questions, if I can. The first is, actually, on a comment I think you made on the tapes, Stuart, which was around the dividend and the bank levy, saying the bank levy was a bit of a hindrance on your ability to continue with a progressive dividend, and I just wondered if you could maybe just add a few comments there in terms of how you think about that.

Stuart Gulliver

Yes, sure, I'd be happy to. So, look, it doesn't change our policy to make the dividend progressive, so there's no change in our view that the dividend is a core part of the reason people own the stock, and our capacity to generate dividend is quite clear from the first quarter's numbers. But what we're actually looking at is the mass of this. So, we paid $9.6 billion in dividend last year, and the jump in the Levy, with the stuff announced in the recent budget, goes from about 1.1 billion to 1.5, so that's 400 million that's added on. And if you think about growing the dividend at 5% on 9.6 billion, it's roughly 470 million, 480 million of growth there in that dividend. And then you think about what the Chancellor said, that it's now a permanent part of the tax system, and then remember the Shadow Chancellor talked about adding £800 million to the bank levy, let's assume that it's $1.2 billion to keep the FX number easy, and we've seen this pick up about a third to 40% of it, there goes another quick 400 million.

So, what I'm articulating is, clearly, one of the reasons why we are starting a process to review where the headquarters of the holding company should be is informed by that. So, what I'm not saying is we've changed our dividend policy; what I'm pointing out is one of the reasons that we are reviewing where the headquarters of the holding company should be is the size of the Levy and the size of the jumps in the Levy in proportion to the size of the jumps in the increase in the dividend. And as you know, this is a pre-dividend distribution; this comes profit before tax. It's not a tax.

John-Paul Crutchley

Understood. The second one was just: I just wondered whether you can make a comment around the impairment charge, particularly in the LatAm business, which still seems quite elevated. I know you've, obviously, had some historic issues there, and just how you see that one playing out, because I would have thought that would be starting to normalise by now.

Iain Mackay

I think, as it relates to loan impairment charges, we're probably seeing what is, in actual fact, a reasonably normalised level within Latin America. As you probably can recall, over the course of the last four years, we've continued to reposition the Latin American portfolios – in fact, portfolios around the world – to a higher proportion of secured. But nonetheless, as we reposition that portfolio and loan impairment charges are somewhat lower as a consequence of that, we still hold quite a large proportion of unsecured debt within the Latin American book, and that naturally incurs a higher proportion of loan impairment charges. So, I think there is a balancing point between the revenue and the loan impairment charges that we need to consider not only within our Latin American businesses and others, and striking the right proportionality between secured and unsecured product and the revenues that can be generated from that on a risk-adjusted basis. But I think we're looking at, based on the current composition of the balance sheet, a reasonably normalised loan impairment charge for Latin America. And by that, what I mean is there's nothing unusual coming through this quarter for LatAm.

John-Paul Crutchley

That's helpful, thank you.

Alastair Ryan, Bank of America

Two from me, please: first, I'm, clearly, fairly hopeless at forecasting your costs. You were as much better in Q1 as you were worse in Q4. Just whether there's a level of noise in that – clearly, there were relatively low conduct charges this quarter – or whether you've made early progress on that new cost target. So, is that noise or underlying progress in Q1?

And second, GBM was the one part of the Bank that grew its risk-weighted assets in Q1. I'd back out that it probably grew its total assets as well. It's now about 43% of total risk-weighted assets. Is that heading in the right direction? This might be a question for June, really, but it's growing in proportion to the total mix and, historically, you've wanted it to be somewhat smaller than its current starting point. Thank you.

Iain Mackay

Yes. Thanks, Alastair. So, let me take your Global Banking and Markets risk-weighted assets point first. So, within Global Banking and Markets, total risk-weighted assets were about 520 billion. 70 billion of that is Balance Sheet Management, so our corporate surplus, and about 44 billion of that is legacy credit, so the SICs and SIVs sitting within Global Banking and Markets. I think, as everybody appreciates, when you look at our capital surplus, that sitting within Global Banking and Markets perhaps somewhat artificially inflates the view both of the size of the balance sheet on a nominal basis as well as a risk-weighted basis within that. In the current quarter, as in previous quarters, the Global Banking and Markets team is very, very focused on managing not only the absolute number of risk-weighted assets but, more importantly, the return on those risk-weighted assets that the business is able to generate, and we will go into considerably more detail about this on 9 June. We clearly recognise that as an important part of giving clarity to the market about how we move returns for the Group from below 10% to above 10% – the numbers we talked about back in February.

Specifically within the first quarter, the main adjustment that we saw coming through was actually in market risk, where a number of trades that we undertook actually impacted, through the incremental risk-charge model, a significant adjustment. Now, that model was subject to certain change as required by the PRA last year, and I think it would be fair to say that there are still considerable refinements required within that model for it accurately to reflect the performance of certain aspects of the Markets business, and we're very focused on that. Beyond that, the increase in risk-weighted assets was really in line with the growth in the balance sheet, offset by continuing improvements in quality of the Global Banking and Markets book from a credit perspective overall, Alastair, but we'll go into this in considerably more detail on 9 June.

On costs, I'm not sure that we would change significantly the guidance that we provided to you on 23 February around costs. When we look at investment in the growth of the business, making sure that we are properly resourced and equipped to meet the requirements from a DPA, Global Standards and overall Conduct Compliance perspective, we are still very much focused on ensuring that we've got a cost profile that takes us to flat exiting 2017, into '18, with a cost profile on an adjusted basis in 2014. We've remained focused on cost management throughout the last four years. That's equally so in the first quarter of 2015, and certainly, from a cost perspective, it would be fair to say that we came in slightly better than our expectations for the first quarter, and our expectations are defined by our plan. So, we came in slightly better than our plan for the first quarter, and our goal, clearly, will be to continue to improve and build on that performance. But the underlying guidance is still the guidance that we provided to you on 23 February in this regard, which recognises an investment cycle with a view to coming out of 2017 with a run rate that would be consistent with an adjusted basis in 2014, as we talked about then.

There's obviously lumpiness in that, Alastair, and you obviously get the fourth quarter, which is a mess, because of the bank levy, and Stuart talked a little bit more about that. And then, clearly, on an adjusted basis, this does not include fines, penalties, customer redress and settlements, and it's the very reason that we extracted from the reported to arrive at adjusted, so that we can try and provide some clarity, not only to ourselves, but to our investors and other people who read our financials about what the operating cost base of the firm is. Again, this is an area into which we will give more insight and greater detail and clarity on 9 June. And by that, I mean how we're doing and what we're doing: how we get from where we are to where we want to be.

Stuart Gulliver

Yes, we realise we're going to need to provide a very detailed cost walk, which we'll do on the 9th.

Martin Leitgeb, Goldman Sachs

I thought there was a comment made earlier whether you continue to assess Brazil, Mexico, Turkey and the US businesses to intense scrutiny on whether they should be kept or not going forward within the HSBC umbrella, and I was just wondering – and I'm well aware here, obviously, of 9 June – whether you could share your thinking in terms of what would the key parameters be on which the decision whether to keep those subsidiaries or not is made. Thank you.

Stuart Gulliver

We'll go into it in detail on 9 June. It's a fairly obvious core part of the 9 June presentation.

Ronit Ghose, Citi

I just have two areas of questioning: one is on fee income and the second is on capital. The fee-income numbers are a bit below our expectations and I was just digging into the Europe RBWM fee income. I know, Iain, you said that there was a change in overdrafts to the practice. How much of that decline, which is roughly over 20% year-on-year and Q-on-Q, in fee income in RBWM is just FX translation, and how much is this change in overdraft process, and how much of it is other factors? I'm just curious as to any more colour you can give us around that trend.

And the second area of questioning is around capital, and two sub-questions here: one is your UK plc, your UK legal entity. The full-year numbers, you said at the time that it was a 9% core equity tier 1 fully loaded, and 8.7 transitional, and I wondered if there was any colour you can share around that capital number in terms of what the regulator or the UK PRA wants you to be at. Because I know we've talked about the Group before, and the Group, you've talked about a 12-13% number for the Group. Specifically for the UK, if you have a similar number as a go-to number for the UK division. And a very small question on capital: it looks like it's about a 10% hit in the quarter on the Group capital from FX translation. Is that mainly driven by sterling and euro declines or are there other EM currencies affecting that? I'm just looking at the RWA moves and the capital moves, and it's almost about 10 basis points down quarter-on-quarter. Thank you.

Iain Mackay

Yes. So, I'll take you last question first, Ronit. It was nine basis points that came off the common equity tier 1 ratio in the first quarter. Main currencies impacting that: euro against the dollar, sterling against the dollar, and then, to a lesser extent, the Brazilian real and the Canadian dollar. The composition of that was, I think, about 33 basis points off capital with about a 24-basis-point add-on back from a risk-weighted-asset perspective, so a net of nine bps on capital in the first quarter from foreign exchange.

Fee income: one of the drivers within fee income, certainly, was this change in practice as it related to overdrafts in the United Kingdom, where, if you are with HSBC now and you're likely to run into overdraft, you'll get a text message from us indicating that you will, and a guidance or a suggestion that there's an opportunity to remediate that before you start incurring fees. The impact from currency translation within the Europe Retail Banking and Wealth Management actually represented about a 10% impact on overall fee income generated within that business in the quarter, and then that was compounded by the change in overdraft practice as it relates to that text-messaging approach. So, those are the main drivers of the fee income.

From a capital perspective, the UK bank ratio: the UK bank, this year, for the first time, will be a specific subject of the stress-testing. Last year, it was the Group that was focused from a stress-test standpoint; this year, the PRA has requested that we provide a submission that is specific to the UK, and as a consequence of which I think it's reasonable to assume that the regulator is turning its attention not only to Group capital but the capital of the UK bank and, in that context, specifically a view to recovery and resolution, presumably but not decidedly under a multiple point-of-entry resolution construct.

I'm not sure. Clearly, the UK bank exceeds the minimum required from a PRA perspective. I think, actually, it's very, very difficult to say at this point in time whether the PRA has a specific number in mind for the UK bank, whether that would be approximate to the Group, to what their expectations are for the Group, and I think we've been clear previously that the PRA have set out an expectation for the Group of common equity tier 1 under the most recent internal capital guidance of about 10.6%. That includes the Pillar 2A buffer in that regard.

So, more to come on the UK Bank on a standalone basis, almost certainly informed by stress-testing and the outcome of that. So, as that develops, we'll share more but, at the moment, the UK Bank exceeds the minimum requirements within the UK quite comfortably.

Ronit Ghose

Thanks for that, Iain, that's really helpful. Just to follow up on the question on the UK capital, I'm just thinking about if your last reported 8.7/9, I guess the direction of travel is clear and, at the Group level, it's going up. But I guess, at the UK, shall I assume it's going up even faster because… And I'm looking at where Lloyds and RBS want to get to, a kind of 12-13 number. Maybe your balance sheet is higher quality than those two banks in the UK, but it feels like there's going to be a clear uplift in the UK capital compared to an 8.7/9. Is that a fair assumption that your UK ratio will have to go up more than your Group ratio going forward?

Iain Mackay

I don't know. I can't answer that question for you. I really don't know. I don't know what's informed Lloyds and RBS, and they've obviously been under quite close scrutiny for the last six years, so we're not having similar conversations with the PRA, but I think it is reasonable to assume that, as the PRA have requested a specific view of the UK Bank under stress-testing, that that will, in some way, inform their view as to capital requirements for the UK Bank going forward.

Tom Rayner, Exane

Stuart, could I just ask a little bit more on some of the comments certainly attributed to you from the media call this morning? It reports you as saying that you do believe the HKMA would be more than capable of regulating HSBC, so just on that point, I wonder if you could comment on, if that were the case, given the size of balance sheet versus size of domestic economy, what you might be thinking in terms of domestic systemic buffers that might be then put in place? So, that's the first point.

The second thing is back to the bank levy, because I'm just interested in why you're mentioning the dividend policy at this stage, and trying to get a sense of: is there any concern building that, with the revenue pressures plus the inflation in the bank levy, that you just might not be able to maintain this policy, or is this trying to give more strength and support to your view that, if something doesn't change, then the whole domicile question becomes a very real one? I'm just trying to get a sense of what message you're trying to put out there from those comments this morning. Thank you.

Stuart Gulliver

So, I think, in terms of the second one, it's all of those things. If interest rates are near the zero bound, and you're a big deposit-funded bank and, therefore, revenue is hard to generate, and even an activity which is core, such as Payments and Cash Management, if you've got interest rates near the zero bound and wholesale liabilities are subject to a bank levy, that, itself, therefore, becomes a dilutive business, but it's core to the stickiness of your Global Banking and Markets relationship, so you'd probably have to persist with it. You don't have a lot of levers to cover off big jumps of half a billion a pop in your bank levy, so it's basically a reflection of a reality that we see. And I think someone somewhere else said that maybe there'd be less issues around the levy if interest rates were at 4% and we were all making a hell of a lot more money, and that's probably true, but I think we're in the environment we're in for quite a bit of time. That comment I've just made is even more acute if you're dealing with euros, where, actually, interest rates are negative.

So, there's nothing more clever in it than pointing out that one of the factors that, clearly, we will be looking at in terms of where we headquarter the company is the size of the levy, the fact that it is applied on our global balance sheet, the fact that it's been put up, what, nine times, and we are a very big proportion of raising a fixed amount, for reasons that you well understand. It does not, in any way, shape of form, inform the view as to our own intent to make the dividend progressive. So, I want to be crystal-clear about that: that's not what I'm saying. What I'm alerting you to, is to why we would be deciding, at this moment in time, to look at where we headquarter the holding company, and that's a situation that I think a number of shareholders have also drawn to our attention in investor meetings that Iain and I have both had. Clearly, there's a whole stack of other positive things about where you might choose to put the headquarters of the company, and they represent 20-year views on where the fastest economic growth is going to be in the world etc, but what we'll do on 9 June is we'll set out some of the criteria that we will be using, because this is a non-trivial decision that we'll need to look at.

My comments specifically about the Hong Kong Monetary Authority stand. I think that they have the technical capability and, indeed, today, they are actually regulating the Hongkong and Shanghai Banking Corporation, which is about 70% or 80% of the PBT of the company that you cover. I also think that some comment about there's only 700 people in the HKMA is kind of missing the point. I think the team that covers us at the PRA is under 50 people, and I also think that one should bear in mind that the lining up of balance-sheet footings within a specific economy is tending to suggest, Tom, that you don't think multiple point of entry works. Because if you think multiple point of entry works, then it doesn't all roll up either to the UK or roll up to Hong Kong or roll up to any third place. So, therefore, multiple point of entry, if you like, is the rebuttal of the argument that the economy needs to have the footings of the GDP – or, sorry, the GDP needs to be bigger than the footings of the Bank, because multiple point of entry suggests the whole thing doesn't roll up to one place. But in any event, even if you didn't believe that, Hong Kong is a Special Administrative Region of China that, clearly, does have rather a large GDP.

Iain Mackay

Just around the systemic buffers in Hong Kong, HKMA has already announced what the D-SIFI buffers or D-SIB buffers will be within Hong Kong, taking effect and phasing in from 1 January 2016 to 2019, and our buffer requirement has already been announced to the marketplace in that regard and it'll be phased in over the course of the next three years. So, there's no mystery around that at all.

Tom Rayner

Sure. So, is this a red line that you're drawing, though, Stuart? By making something that is so important and everyone knows is such an important thing to management – the progressive dividend policy – by attaching that to the bank levy, it just feels like you're drawing a bit of a red line and making it even stronger, maybe, than you have in the past, or is that just trying to read too much?

Stuart Gulliver

I think that's trying to read too much. It's part of a number of things that we'll look at and analyse as to what we might do. If, by some strange situation, interest rates rose and we were making a ton more revenue, then some of the pressure that comes from that bank levy drops away. But the bank levy is, clearly, one of several things that we'll examine, so, no, I think you're getting beyond what my intent was in terms of the media call.

Raul Sinha, JP Morgan

Can I have two, please? So, the first one is relatively straightforward, on balance-sheet management: you had a very strong quarter there but it looks like you had some AFS gains. Could you give us the underlying amount for BSM this quarter, so we can form a view on what it might end up for the rest of the year and, if you've got any thoughts on what it should be for the rest of the year, that would be great.

Stuart Gulliver

So, to make it easy, I think the rest of the year, between 2.6 and 2.9 for total year. So, total-year BSM between 2.6 and 2.9 billion.

Iain Mackay

And to be clear, Raul, Balance Sheet Management has, in any given month, any given quarter, AFS dispositions, and gains or losses on that. It is, in actual fact, part of how BSM is invested.

Stuart Gulliver

Yes, it's part of how we manage the liquidity of the Group. But as I say, full year, 2.6 to 2.9.

Raul Sinha

Fantastic. The second one is just going back to the discussion you were having with Tom about re-domicile. Firstly, so that we are informed about how you are looking at this issue, can I ask a couple of questions about, firstly, how much of the levy you would expect to lose if you became a foreign bank in the UK? My understanding is that the levy applies to the GBM balance sheet, effectively, looking at the details of it, so would you be considering moving a large chunk of your GBM balance sheet out of your UK sub in your analysis? And then, clearly, it looks like you would still expect to run with TLAC rules as they apply, if you moved to an EM country. As you know, TLAC doesn't apply to EM countries, as the current rules are set.

Stuart Gulliver

So, look, whatever decision we make around the headquarters of the holding company, it's not going to be about regulatory arbitrage. I don't think that has any advantage to a bank of our size and scale whatsoever. So, this would not be motivated by any attempt to avoid TLAC by going to an emerging market. And actually, if you think about it, the big emerging market that does have this is China, because the state owns the banks. So, that's a different set of criteria than would be applied to us.

You're right that GBM will attract the levy, come what may, and we will be talking on 9 June about what we're going to do to GBM in terms of improving returns generally, and that may involve moving some of the GBM activities out of the UK. You're entirely right because whatever non-ringfenced bank we leave behind will be subject to the levy, because it will have wholesale liabilities that aren't subject to deposit insurance. That's the point about Payments and Cash Management that I was mentioning earlier. But if you just look at how much of the levy applies of the 1.2 that we currently have to the non-UK part, it's about 50% of it.

Manus Costello, Autonomous

I just had a few questions following up on some guidance you had previously given for the year. Iain, you'd talked about a run rate of about 9.5 billion of costs per quarter this year in our post-results meeting, and I wondered if that was still standing or if you now thought you could out-achieve that. And you also talked about provisions being higher in '15 than in '14, and I wondered if you were sticking to that guidance as well.

Iain Mackay

So, I think the guidance we actually put out there was that we would be looking to maintain a cost run rate in 2018 which was consistent with '14 on an adjusted basis, which, if you do a straight division of the quarters, would be 9.5, but you've got to reflect on the fact that the bank levy always falls in the fourth quarter and tends to skew it. I think, if you normalise that out, excluding the fourth quarter, you're looking at something that sits between 8.8 and 9.2 from a quarterly expense perspective, and I think our guidance in that regard will remain consistent. Clearly, our focus is to continue to improve the overall cost position of the firm, and we'll give you more details as to how we're going to accomplish that on 9 June. But in the round, in terms of big numbers for the total year, what we are targeting is an investment profile over '15, '16 and '17 such that we exit '17 with a run rate that would give us an adjusted cost base consistent with that of adjusted cost base in 2014.

On the LICs, this is an incredibly difficult number to forecast. We've obviously got a first quarter which shows a very, very stable credit environment around, really, all of our operating regions. There's nothing particularly unusual coming through any of them. We do have some recoveries and credits coming through the loan impairment charge line specifically within Global Banking and Markets relating to prior periods, as we've experienced recoveries through restructuring. Areas where we continue to monitor very closely, obviously, is the oil and gas sector, is Europe in the round but specifically Greece, notwithstanding the fact that our exposures in terms of balance-sheet footings is, actually, very small within Greece, and we continue to monitor, at an enhanced level, what's going on in the Asian markets. But again, what you see in the loan impairment charge in our Asian markets in the first quarter is a very, very stable credit-quality picture.

So, we were sitting at very low levels in the round of loan impairment charges in 2014. We've got a good start to 2015. Very, very difficult to guide on this one. I think, logically, based on coming out of '14, you'd have seen something a little bit higher but you just continue to be amazed about how well overall credit is holding up.

Manus Costello

Okay. Thank you. Just one separate follow-up on a different point: you had also talked at the full-year results about potentially hedging your exposure to sterling through the election period, and we saw, as you referenced, still some volatility from FX on the capital line. I wondered if you could update us on how you're positioned into Thursday and Friday.

Iain Mackay

Long before the election, we'd undertaken significant hedging activities of the sterling structural FX position, to the point that almost 90% of the position is hedged and, in actual fact, the volatility that you saw, which was somewhat muted in the quarter – I think, of the nine basis points, I think two basis points of that volatility came from sterling, and that was reflective of the 10% that remains unhedged and a proportion that we hedged about halfway through the quarter, so –

Manus Costello

Any sterling weakness wouldn't lead to capital weakness or non-material capital weakness.

Stuart Gulliver

It would not.

Chris Manners, Morgan Stanley

Two questions, if I may. The first one was on revenues: obviously, Q1 revenues in CMB and RBWM were down year on year, but then, if you adjust for FX, they were actually reasonably positive. Maybe you could just give us some sort of outlook on what you expect for the sequential improvement in both of those two business lines for the rest of the year. And the second one was just on costs again: am I to take it that, when you say you take the 2014 adjusted-cost base, if I look at slide 8 and I add up all of the cost numbers there, I'm getting to a $36.3 billion adjusted-cost base, just looking at the darker bars there, so would that be the number that we would be consistent with in our 2017 exit rate now; i.e. a bit lower than it was before? Thanks.

Iain Mackay

So, we're always going to talk about this on a constant-currency basis, and that moves, obviously, with the composition of currency mix against the US dollar, which is our reporting currency. I think, at the end of the year, when we were talking about this, we were talking about an adjusted cost base of about US$38 billion.

Chris Manners

Perfect. So, that might have slipped down quite a bit now, given the dollar move.

Iain Mackay

Yes. As far as revenues, we had a good quarter, with some revenue growth coming through each of the global businesses. We obviously continued to reposition Global Banking and Markets, but, as Stuart mentioned, we've seen net new money coming into those parts of Private Banking which were particularly focused on growth, and a lot of that net new money came through collaboration with Retail Banking and Wealth Management and Global Banking and Markets, as well as Commercial Bank. Retail Banking and Wealth Management, reasonably encouraging; CMB reasonably encouraging, with the usual characteristics of the first quarter from a Global Banking and Markets perspective.

Again, we're not going to sit and give you projections for revenue for the year. Every time we give you a projection, something happens in one of the economies that we're operating in, where it almost invariably invalidates it within two or three weeks. So, look, we're very focused on continuing to enable each of these businesses to grow in their markets but grow in line with the risk appetite. We're encouraged by the first quarter, and the businesses are focused on continuing to grow the businesses.

Stuart Gulliver

I guess just a couple of bits of additional colour: so, in CMB, a lot of this comes off the fact that we've got much higher balance-sheet growth a year ago, which is now coming through in net interest income. In RBWM, there was a strong performance in the first quarter in Wealth Management products, particularly in Asia, from life-insurance manufacturing and because we had a big equity market rally here in Asia-Pacific, so a lot of it is wealth. But as Iain says, we've got revenue increase in principal RBWM of about a couple of hundred million, in CMB of a couple of hundred million, compared to first quarter last year, and in Global Banking and Markets of about 400 million. So, it's been a good first quarter for revenue.

Fahed Kunwar, Redburn

I just had a follow-up on the revenue point. It's on net interest income. Obviously, your net interest income came down, and a chunk of that probably is FX in 1Q15 and 4Q14 but, on an adjusted basis, your balance sheet looks to be slightly up. So, I'm just trying to understand the margin guidance or the margin commentary you gave. It looks like margins were flat on 1Q and 4Q14, but your cost of funding is not moving, your gross yields on customer lending are coming down, and there was a reverse repo offset in that margin analysis as well. So, I'm just trying to see how much… If you put it at a constant FX basis, how do you square the NII coming down slightly, the margins flat and the balance sheet up? And then is that reverse repo margin benefit a sustainable thing going forward, looking to offset your gross yields on lending, or is that a one-off in this quarter? Thank you.

Iain Mackay

So, on an adjusted basis, net interest income was up 2% in the quarter; so, adjusted, that's constant currency and any significant items. So, we are about 2% up in net interest income. Broadly, net interest margins are stable. We've actually had some positive progression within the UK Bank. Asia is broadly flat; Latin America, some downward pressures. The yield on a mixed to more secure product and higher cost of funds comes through to offset some of the headway that we've been making within the UK Bank. Broadly stable within the Middle East and North African businesses. And North America, I think that's where we tend to have seen… both North America and the UK is where we've seen some of the offset coming through the reverse repo business. But broadly speaking, a positive performance in the UK, with some offset coming through Latin America and North America mix.

Fahed Kunwar

I see. Okay. Just so I understand, you said offset by the reverse repo business. So, basically, you had a yield increase in the reverse repo business, so, basically, your cost of funding increase in your reverse repo has not offset the asset yields, but otherwise your margin is kind of ticking along nicely.

Iain Mackay

Yes, the margin is fairly stable. I think what we have seen, particularly in the US, is that there's been an increased impact in the first quarter from surplus liquidity in the marketplace, which has come through reverse repos but, other than that, nothing of particular note.

Chintan Joshi, Nomura

I have a few follow-ups. The first one is on cost; a second one is UK margins; and a third one on TLAC. Hopefully, they're all quick. On the cost, Iain, you mentioned 8.8 to 9.2. This is still higher than the first-quarter run rate, and you have generally tended to hold the first-quarter run rate in previous years broadly speaking, so just wondering why 8.8 to 9.2. Should we expect inflation quarter on quarter over the next few quarters?

Then, on UK margins, you said UK margins were positive. HSBC has got one of the lowest rates on mortgages amongst the UK banks. I would have thought there would be pressure on UK margins. I suspect cost of deposits is falling. Can you give us what the weighted average cost of deposit for UK is, just to get a sense of how it's moved?

And finally, on TLAC, just following up, how important is the TLAC relaxation on the EM balance sheet in the debate around re-domiciling? Thanks.

Iain Mackay

So, the last one: there's not a reg-arbitrage deal here on TLAC, Chintan, at all. One of the –

Chintan Joshi

But even without the reg-arbitrage, there are substantial savings to be had if you get the EM relaxation.

Stuart Gulliver

Well, there might be, but, as far as we can see, the EM relaxation in this part of the world where we're sitting tonight is partly there because China owns the banks. So that's why they got the carve-out: it's actually they're state-owned.

Iain Mackay

The regulatory politics behind this, it's not because it's EM; it's because the Chinese own their banks and pre-fund resolution, if you like, in that regard. So, there's an ownership structure which is fundamentally different in that regard, Chintan, so I don't think simply were we to contemplate, following all the analysis, and make a decision, (a) I don't think the Special Administrative Region of Hong Kong is included within the emerging-market definition, and (b) the whole ownership structure of the bank is entirely different. So, I'm not sure there's a reg-arbitrage play there from a TLAC standpoint.

From a UK margin perspective, it is principally the cost of funds which has given us some margin expansion within the UK. We've obviously seen some pressure on yield on UK mortgages, but that, generally speaking, has been more than offset by a lower cost of funds coming through the UK Bank. I don't have the average weighted cost of funds sitting right in front of me at the moment, Chintan, but that's the explanation behind it.

From a cost perspective, again, some of the things that we talked about in February were the need to make continued investment in the growth of the business, the regulatory programmes and compliance, with a lot of the regulatory compliance phasing in through '14, '15, '16, '17, '18 and '19, influenced also by the continued investment in meeting requirements of the Deferred Prosecution Agreement and, broadly, the deployment of Global Standards and conduct compliance. And so, it's really catering towards that investment profile and recognising that we've got inflationary pressures coming through particularly our Latin American and Asian markets, and most notably in Latin America, where there are, each year, negotiated union settlements which are factored into the cost base as a matter of course.

So, a lot of what we will speak to you – or some of what we will speak to you – about on 9 June is going through that investment profile, looking at the inflation that we've got to be able to fund through cost efficiencies, looking at some of the investment profile that we've got there and what we need to do to be able to fund that as well. So, the guidance I gave around cost factors in inflation, factors in the fact that we're going to continue to invest in growing this business over the coming years, whilst recognising that we will, in the longer term, get benefits from some of the technology that we're deploying, particularly within the Global Standards space.

Stuart Gulliver

Thank you. That concludes today's analyst and investor call. Thanks very much for joining us.