# Edited Transcript
# 3Q 2016 Earnings Release
## Conference call with 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 afternoon from Hong Kong, good morning in London, and welcome to the 2016 HSBC Third Quarter Results Call. Iain is with me today in Hong Kong.

Adjusted profit before tax was $5.6 billion, up 7% on last year's third quarter with increases in all four Global Businesses and four out of the five regions. Reported profit before tax of $843 million included the impact of the disposal of our operations in Brazil, changes in the fair value of our own debt and costs-to-achieve. Our global universal-banking model generated higher adjusted revenue than the same period last year and our cost-reduction programmes continue to reduce our operating expenses. This produced positive jaws of 5.6% for the third quarter and positive jaws of 1.5% for the first nine months of this year. Our Global Banking and Markets business had strong adjusted revenue growth in the quarter with market share gains in Debt Capital Markets globally and Rates and Credit in Europe. We also achieved one of our highest rankings in market shares for global cross-border M&A.

In Principal Retail Banking and Wealth Management performance was good, mainly due to the impact of stock market movements on our Insurance business in Asia. Commercial Banking revenue remains stable as higher balances in Global Liquidity and Cash Management helped to mitigate the impact of lower revenue from Trade Finance.

We also increased market share in a number of key markets and international product areas including Trade Finance in both Hong Kong and Singapore. Our loan impairment charges were lower than the second quarter, but higher than last year's third quarter due to increased charges in Retail Banking and Wealth Management in Mexico and small, specific increases in Hong Kong and Mainland China.

Following the change in the regulatory treatment of our investment in Bank of Communications, our Common Equity Tier 1 capital ratio increased to 13.9%. This is another action forming part of our ongoing capital management of the Group that reinforces our ability to support the dividend, invest in the business and, over the medium term, to contemplate share buy-backs, as appropriate. It also provides us with a significant capacity to manage the continuing uncertain regulatory environment.

Including the impact of the Brazil disposal we generated a further $57 billion of risk-weighted asset savings in the third quarter which takes us more than 80% of the way towards our RWA reduction target. Finally, we completed 59% of our $2.5 billion equity buyback as at 31 October. We expect to finish the programme by the end of 2016 or early in the first quarter of 2017 depending on market trading volumes in the fourth quarter. Iain will now take you through the numbers.

## Iain Mackay, Group Finance Director

Looking quickly at some key metrics for the year-to-date, the reported return on average ordinary shareholders' equity was 4.4%. The reported return on average tangible equity was 5.3% and on an adjusted basis we had positive jaws of 1.5%. The movement in jaws was due to a 4% reduction in adjusted operating expenses which exceeded the 2% fall in adjusted revenue in the first nine months of the year.

Slide four takes us from reported to adjusted. For the purpose of comparison throughout the presentation, the adjusted numbers exclude the operating results of our Brazil business from all periods.

Reported profit before tax of $843 million for the third quarter included a $1.7 billion loss on the disposal of Brazil, a $1.4 billion adverse fair value movement in our own credit spread compared with a $1.1 billion favourable movement in the third quarter of last year. $1 billion of costs to achieve related largely to technology upgrades and optimisation programmes and $456 million related to UK customer redress of which $439 million related to Payment Protection Insurance. Allowing for significant items resulted in an adjusted profit before tax of $5.6 billion.

You will find more details on these adjustments in the Appendix. The remainder of the presentation focuses on the adjusted numbers. The next few slides will provide a rundown of our performance in the third quarter.

Adjusted profit before tax was $351 million higher than the third quarter of 2015 due to increased revenue and reduced costs. As Stuart said, profits are up in all four of our global businesses and in every region except North America. The decrease in 'Other' included additional interest payable on our debt and intra-group adjustments which are largely offset within the global businesses.

Slide six analyses revenue, which was up 2% in the third quarter and down 2% for the year-to-date. In Principal Retail Banking and Wealth Management revenue was $396 million or 9% higher than the third quarter of 2015. This was due mainly to a $309 million increase in Wealth Management revenue, arising from much improved market conditions in insurance manufacturing in Asia when compared to last year. Current account and savings revenue also increased by $76 million, primarily due to higher deposit balances and wider spreads in Hong Kong, Mexico and Argentina. We also grew lending volumes in Hong Kong, the UK and Mexico.

Commercial Banking revenue was broadly unchanged in spite of the continuing slow-down in global trade as higher balances in Global Liquidity and Cash Management helped reduce the impact of lower revenue from trade finance. Commercial Banking revenue for the year-to-date was 2% higher than the same period in 2015.

Client-facing Global Banking and Markets and Balance Sheet Management revenue was up by $395 million or 10%. This was driven by increases in market share and improved client flows in our fixed income businesses. Revenue also rose in Principal Investments from higher gains on disposal.

Slide seven covers loan impairment charges which were $132 million higher than the third quarter of 2015, but $207 million lower than this year's second quarter. This reduction was mainly in Global Banking and Markets in the United States as the second quarter included a significant specific charge in a mining-related exposure. There is a detailed overview of our oil and gas, metals and mining, UK lending and mainland China exposures in the appendix.

Adjusted operating expenses were $266 million or 4% lower than the third quarter of 2015 and broadly unchanged from the second quarter of 2016. Operating expenses for the first nine months were $889 million or 4% lower than the same period last year. We achieved this reduction whilst also absorbing inflation and continuing to invest in regulatory programmes and compliance.

We delivered $649 million of cost savings in the third quarter which was $178 million more than we delivered in the second quarter. On a run-rate basis we have now achieved more than $2.8 billion of cost savings and are on track to achieve the top end of our cost savings target. The right-hand side of slide 9 gives you a sense of where these savings are being achieved.

Slide 10 breaks down adjusted profits for the year-to-date by global business and geography. Adjusted profit before tax was down 6% at the same point last year due to lower revenue and higher loan impairment charges, but was largely offset by good progress and costs. The effectiveness of our cost reduction programmes means that we have achieved positive jaws of 1.5% for the nine months in spite of the tough revenue environment.

Turning to capital, the Group's Common Equity Tier 1 ratio was 13.9% on 30 September compared with 12.1% at the end of the second quarter. This increase was linked to the disposal of the Brazil business, completed on 1 July this year, profit generation in the quarter and the impact of a change in the regulatory capital treatment of our 19% investment in BoCom. It also includes the full impact of our buy-back programme. The BoCom treatment changed from proportional consolidation to a deduction from capital, subject to regulatory thresholds. This resulted in $121 billion decrease in net reported risk-weighted assets related to the BoCom investment, and a threshold deduction from capital of $5.6 billion. This raises our reported Common Equity Tier 1 ratio by 104 basis points.

Total risk-weighted assets reduced by $178 billion in the third quarter. We generated a further $57 billion of risk-weighted asset reductions in the third quarter, bringing total reductions for the year so far to $105 billion, excluding the impact of the change in the BoCom treatment. $40 billion of reductions came from the sale of Brazil, $7 billion from Global Banking and Markets, $3 billion from our CML run-off portfolios and $7 billion from Commercial Banking. The total reduction since the start of 2015 now stands at $229 billion, around 45% of which came from Global Banking and Markets. This takes us more than 80% of the way towards our target.

Slide 13 shows Group return metrics. The return on average ordinary shareholders' equity was 4.4% and the return on tangible shareholders' equity was 5.3%. Both of these are significantly down compared to the prior year, primarily reflecting the adverse movement in significant items of $7.5 billion. Excluding significant items and the bank levy, return on equity would stand at 8.3% and return on tangible equity at 8.8%. I will now hand back to Stuart.

## Stuart Gulliver

Slide 14 shows the progress that we have made in implementing our actions so far this year. As you have already heard, our risk-weighted asset reduction through cost-savings programmes continued to make good progress in the third quarter and we remain confident of hitting both targets. Mexico also had a good quarter. Adjusted profits more than doubled compared to last year's third quarter, driven by higher lending and deposit balances across our Retail and Wholesale businesses, and increased synergy revenue. We also captured significant market share in personal loans and mortgages.

The continuing low interest rate environment means that the principal US business will not achieve the target that we set out at our 2015 Investor Update. However, good progress has been made on costs with positive jaws of 6.7% for the first nine months of this year. We have also sold around $900 million of legacy CML assets in the third quarter and another tranche of $900 million at the start of October. We expect to dispose of all remaining CML legacy assets by the end of 2017, subject to market conditions.

Asia contributed 68% of Group adjusted profits in the third quarter and 66% year-to-date. Adjusted profits were up by 14% in ASEAN for the first nine months and insurance manufacturing new business premiums and assets under management in Asia both continued to grow in the third quarter. We also achieved one of our highest ever rankings for China Outbound mergers and acquisitions.

Transaction Banking continued to recover from a difficult first half with revenue for the year-to-date now broadly level with the same period in 2015. Increased balances in Global Liquidity and Cash Management helped to grow its revenue by 6% for the year-to-date. Trade revenue remained under pressure, but we continued to make market share gains in some of the world's biggest trade centres.

We also remain the number one provider for offshore RMB bonds and public sector onshore bonds. In August we acted as joint bookrunner and joint lead underwriter for both the first ever Panda Bond issued by a European sovereign and the first ever Special Drawing Rights bond to be settled in RMB.

It has been a good quarter in what remains challenging operating conditions. The revenue environment continues to be difficult, but we are delivering on costs and have positive jaws for both the third quarter and the first nine months of the year. Our global universal-banking model continues to perform well and we are confident of our ability to sustain the annual dividend at current levels for the foreseeable future through the long-term earnings capacity of the business.

We will now take questions.

## Alastair Ryan, Bank of America Merrill Lynch

On capital, my takeaway at the half-year was that the Group was probably at the lower end of the 12.5-13% range. Now with the accounting change today and bearing in mind that I am sure that you do not know any more than we do about Basel IV, should we think that the lower end of 12.5-13% is still more or less the way, or has that moved? Second, loans and advances, slide 21; can you see positive events in there at present, net, certainly on a constant currency basis? I know sterling keeps going down. Or is the third quarter fairly representative of where things net off at present, which is broadly flat? Thank you.

## Iain Mackay

Capital first of all. The question I think you asked is, do we still see the appropriate range for us from a Common Equity Tier 1 perspective to be in the 12-13% range? The answer to that is yes, but as we said at the half-year, it is probably in the upper half of that range between 12.5% and 13%. So there is no real change in that regard. Obviously the strength of the capital ratio contributed by the disposal of Brazil and the change in the regulatory treatment of BoCom certainly helps us to a very significant degree. It provides us with certainly flexibility in terms of dealing with any uncertainties that will hopefully be clarified in January when we get the feedback from the governors and heads of supervision on the Basel III revisions. But I think, again, that 12.5-13% range, in the medium term, is absolutely the right place for us to be and where we sit right now affords us some flexibility, certainly with respect to sustainability of the dividend and certainly with respect to dealing with any undesirable uncertainty that emanates from Basel III.

As far as loan growth goes, on a constant currency basis we have seen progress, albeit very slow rates, in the loan book over the course of the last few quarters. If you looked at some areas of strength, mortgage lending in the UK: we have expanded the use of the broker channel quite significantly and the underwriting decision certainly still sits absolutely with HSBC, but in terms of sourcing appropriate customers for HSBC, the broker channel is helping significantly. We continued to grow the book in SME and the Commercial Banking business moved ahead quite nicely in the UK in the first nine months of the year. We continued to build the book in Mexico as we rebuild that business in both unsecured personal and in mortgages as well as within the CMB business. Additionally in Hong Kong, although we have seen some reduction in lending principally due to repayment, we have seen more active levels of activity in the third quarter than we have seen in the first half of the year.

Overall it is not necessarily cause to jump up and down for joy, but it is a fairly constructive environment and we continue to progress the book, certainly in line with the risk appetite. We certainly have the capacity to do so and to continue to pursue opportunities across the market, some of which I have mentioned here.

## Rohith Chandra-Rajan, Barclays

Just to come back on the capital. It is really following up on Alastair's question: your positioning this quarter does seem more cautious than certainly my understanding coming out of the Q2 results with the capital ratio obviously clearly very strong now at 13.9%. Is there any change in view in terms of the scale of potential regulatory uncertainty or anything else that we should be bearing in mind when we think about medium term capital returns?

On RBWM particularly in Asia, I noticed a couple of things. One, the wealth management pick up is obviously strong year on year after a weak Q3 2015, but also gaining momentum on Q2. I am wondering how we should think about that going forward. Also, the improvement in the margin there in terms of the reduction in some of the funding costs; you talk about current accounts in particular. Is there any more to go there? Thank you.

## Iain Mackay

Other than the fact that we have executed a couple of big capital actions, there is really no change either with respect to the extent of uncertainty in the regulatory front or any change with respect to what Stuart talked about at the half-year about our outlook on dividends and our outlook on the propensity to do buy-backs. The activity in the third quarter was certainly encouraging, but do not read anything into it in terms of us thinking that we have a regulatory environment any worse than we were informed about at the half-year. Our attitude on the dividends and buy-backs is exactly as it was at the half-year and I certainly would not talk about any greater degree of uncertainty on the regulatory front at this point in time.

Retail Banking Wealth Management is certainly encouraging. I talked about the progress in the UK in that regard. In Asia the overall pick up in the level of activity and the underlying trends within the Equities Markets in the third quarter certainly improved the overall standing of our Wealth Management business. We saw higher levels of activity in customer volume coming through that business in the third quarter. And the insurance manufacturing also experienced a positive swing in market updates and PVIF adjustment. Margin was supported by a larger lower cost of funds. We saw a little bit of pressure on some of the lending margins within Hong Kong, but with higher customer deposits and lower cost of funds coming through, overall the margin was constructive in the third quarter.

As to whether there is more to come in that space, again I would not read too much into it. We certainly would welcome a pick-up in dollar rates and if that came through from the Fed in December it would certainly be encouraging for any of our US-denominated or linked businesses. We are reasonably hopeful, probably with the rest of the market, that we will see some pick up there.

The other thing is overall the first half of this year was very weak when compared to the first half of last year, but what we saw in the third quarter was encouraging trends, broadly speaking, within Wealth Management, the Asian businesses and particularly Hong Kong and mainland China. That is something to be thankful for and the business clearly tries to realise the benefits of those higher levels of activity.

**Raul Sinha, JPMorgan**

To finish off on BoCom: I do not think that it should, but does this capital and accounting change change your thought process around the distributable reserves that you consider when you think about the dividend and buy-backs? Related to that, now that you have had a more favourable accounting treatment for capital, would you have any thoughts about the P&L treatment for BoCom?

**Iain Mackay**

Let me take the second one first. This is purely a change in reg capital treatment. There is no change in the accounting treatment and if anything, and we mentioned this specifically in our note in the earnings release, that this reg treatment much more closely aligns with the actual risk from our investment perspective embedded within BoCom and aligns very closely to equity method of accounting that we have deployed for BoCom since we have owned the 19%-plus stake in it. We will not necessarily be revisiting the method of accounting for BoCom, but as we have in the third quarter and certainly the last 10-12 quarters, we revisit the value in use in terms of assessing whether or not we have an impairment in BoCom given the market value; and where the share currently trades is well below our current carrying value, and that carrying value is informed by the equity method of accounting. However, the method is absolutely consistent and is very likely to remain so going forward, but we will continue to assess it against value in use for possible impairments. As you will have seen from both the half-year disclosure and the disclosure at last year-end, it is a pretty sensitive calculation that we keep a very close eye on.

This has no real impact in terms of distributable profits from the Hong Kong and Shanghai Banking Corporation (HBAP) which owns our 19.03% stake in Bank of Communications and the reason for that is that the distributable profits are informed by HKMA regulatory capital treatment. The regulatory capital treatment in Hong Kong has, since Basel III was implemented, been a deduction from the threshold regime. So if anything there is now a closer alignment across the different treatments, and so this does not in and of itself inform higher distribution capability specifically from HBAP.

**Raul Sinha**

If I can maybe have a follow up on the UK mortgage rate? Earlier you talked about some nice, strong growth there. You obviously have a very high quality book in the UK in terms of mortgages, but it also has a very low risk rating. I was just wondering if you might be able to comment on this PRA consultation bit and if that might have any impact to you?

**Iain Mackay**

The safest thing to say there, Rahul, is that we are still evaluating that. As you have quite rightly pointed out, we have a very high quality book. We have low loan to value ratios within that portfolio, very strong affordability in terms of how those books have been underwritten, and certainly as you have seen coming through credit cost, it is a very low loss incident going through. But we are still evaluating whether that consultation will have any real impact on the UK portfolio. It is a bit too early to say.

**Chirantan Barua, Bernstein**

Stuart mentioned that you are getting market share gains in Hong Kong and Singapore, yet when I see your data you're down about 9% sequentially in Trade Finance which I thought was sharp and you are down in cash as well by 5%. It would be great to understand the underlying trends. Obviously Trade has been struggling globally, macro, your share gains, the margin pressure, the different things moving round; it would be great if you could give us some colour on that.

Second is that it would be great to get an update on this new stamp duty, which has come in Hong Kong, and what you are saying it does to the Q3 tailwinds that you have had in Retail in Hong Kong after a couple of sluggish quarters. Thank you.

### Stuart Gulliver

The stamp duty increase in Hong Kong will, if we look at previous changes to stamp duty - the double stamp duty and the stamp duty introduced for overseas buyers - they both resulted in a substantial reduction in volume, but not a particularly marked change in the price of properties. In both instances within 12-15 weeks, volumes returned and there really was not much change in terms of prices. So I would expect that volumes will drop away, particularly in that sort of price segment and we may well see a little bit of weakness in terms of prices. But, the LTV on the book in Hong Kong is extremely conservative. Yes, there will be a bit of an impact in terms of volumes.

Having said that, in terms of your comment about Hong Kong, our market share in Hong Kong is extremely strong and market share gains in Hong Kong have been quite marked over the course of the year. In Hong Kong our mortgage new business market share increased to 18%. These are all official market statistics published by the HKMA. New business market share is 18.4% in September year-to-date, up from 17.6% in the full year for 2015. We have number one market share in the year-to-date and number one market share in each month on the third quarter. In Deposits our market share is up to 22.5%. Personal lending increased to 19.3% from 18.4%, so there is actually a lot of momentum in Hong Kong. The Hong Kong Retail Banking and Wealth Management numbers are actually very good.

I will let Iain talk to Trade.

### Iain Mackay

From a Trade perspective, certainly from an average assets perspective we have seen a bit of a drop off from this time last year and the most noted component of that has been across Asia with lower levels of activity, and we have talked about that now for the last few quarters. Our Hong Kong trade market share has risen from 7.6% in 2015 to 11.7% in August this year. We've also gained trade market share in Singapore where it has risen from 7.4% to 8.4% over the past year to August. Interestingly, net interest margin has held up pretty well overall for the business globally. That has certainly been somewhat improved by a mix from plain vanilla to structured trade finance products as customers have required a little bit more complexity around hedging exposures in that respect. However, overall the margins have held up pretty well, but when you look at the composition of our trade balances, we have held up well in Europe, Latin America, the Middle East and North Africa, the North American business has held together reasonably well, but we have seen a bit of a tail off in volume in the Asian businesses, which I think is largely from the phenomenon that we have seen of a slowdown in the Chinese economy over the course of the last two or three years. There is nothing really inconsistent. I think one of the counterpoints that I would put out there is that as we have seen some weakness in the Global Trade and Receivables Financing business, we have seen some real strength on a continuing quarter over quarter basis, and now, for a number of quarters, through Global Liquidity and Cash Management, which is the business line formerly known as Payments and Cash Management. There we have seen good pricing, increased balances and improved margins. That, obviously, is a very sticky business, which is attractive to us notwithstanding the fact that it is a pretty low rate environment in which to operate right now.

Broadly across the businesses, both Global Banking and Markets and Commercial Banking, they are very active in these two product sets. Both are showing good progress in Global Liquidity and Cash Management, and that is effectively offsetting the slowdown that we are seeing in the Trade and Receivables Financing.

### Stuart Gulliver

If you look at Trade and Receivables it is kind of flat in the second and third quarters.

**Iain Mackay**

Yes, it is.

**Stuart Gulliver**

The difference is under tens of millions. To be honest, I would say that it is flat for the second and third quarter. That evidences the fact that we have done a pretty good job of taking market share to deal with the fact, as you say, that traded goods are down. The revenue volumes are actually more or less flat for the second and third quarters, which evidences quite a significant pick up in market share.

**Iain Mackay**

When you look at the year over year drop off, it was largely informed by what we saw happening at the end of last year.

**Chintan Joshi, Mediobanca**

I want to ask a question on capital. I take your point that HBAP will not have additional repatriation capacity, but the change in the reg cap should create a surplus at the Group or solo level. I think last quarter you were talking about a $10 billion surplus at that level. Do I presume that that has gone up now and if so how much has it gone up to?

**Iain Mackay**

Certainly moving from 12.1% to 13.9% puts us in a much stronger capital position. What we come back to here again, is where we have capital located around the Group. One of the things that we talked about at the half year was that through the on-going CCAR process we have made some progress in 2016, with no objection to the capital plan. One very specific focus area for the firm over the next few years is to continue to progress our work on CCAR, and progress the opportunity to get surplus capital out of the US and position it within the Group to support the overall growth and strategy of the Group. Broadly speaking, what this certainly would connote is that we have very strong capital ratios sitting in the majority of our businesses around the world, and we are going to continue to take capital actions to ensure that we are were capitalised at a local subsidiary level, but the surpluses sit at the parent level. That clearly will then support the overall flexibility of the Group, the dividend paying capacity and, as and when appropriate, the propensity to revisit the question of buy-backs.

**Chintan Joshi**

I presume we will hear something with the full year results on that front.

**Iain Mackay**

Maybe.

**Chintan Joshi**

In 'Other', the underlying revenues are weaker this quarter. It's running at about $800 million versus an average of about $1.4 billion in previous quarters. There is a bit of a delta there in the underlying 'Other' revenue item. I am just trying to understand what is happening there.

**Iain Mackay**

It is mostly because there have been adverse movements in inter-company derivatives. You see most of that offset within Global Banking and Markets and within Commercial Banking. Though it is not necessarily the most significant element, we also have the increasing influence of TLAC, which contributes a couple of hundred million dollars, which obviously is going the wrong way when we start thinking about 'Other' overall. It is mostly on inter-company derivative positions within the Global Banking and Markets business, and the offsets sitting within 'Other'. It is inter-segment stuff that is principally going on there.

**Katherine Lei, JPMorgan**

I think China is going to make lenders using UnionPay buy insurance products overseas. I heard from management that part of the reason for a stronger retail banking business in Asia, maybe specifically in Hong Kong, is due to the insurance product. What do you think the impact will be and how should that impact the revenue outlook in the coming quarters?

**Iain Mackay**

This does not have an impact on us, as we do not accept China UnionPay as a payment channel.

**Tom Rayner, Exane**

Can I speak on this issue of BoCom and, more broadly, on the capital, Iain? If I have understood what you have just said, in order for the surplus capital to start being used, either for dividends or further buy-backs, you need to get it to the Group. The US stuff is trapped, and the US currently needs to be released, which is starting to occur. It sounds as if the 100 basis points gain from the change in regulatory treatment of BoCom is going to remain trapped in the Hong Kong subsidiary, because that was how they were looking at it already. Does that suggest that none of that 100 basis points gain is really going to be available to you for future dividends/buy-backs? Do I understand that correctly? I know a few people have asked, but I do not quite get it yet.

**Iain Mackay**

I would not say that at all, Tom. We have very strong capital ratios in each of our affiliates in Asia, whether you look at Hong Kong and Hang Seng within Hong Kong, or whether you look at mainland China. All of those businesses represent greater dividend paying capacity. Part of what we have worked through with our subsidiaries here, and which, frankly, we will continue to work through for the next year or so, is the jurisdictional implementation of Basel III and the phasing of that. All of our subsidiaries around the world meet and exceed local regulatory capital requirements. Part of the overall management action within the Group is just to ensure a sharpness of compliance with local regulatory capital ratios, but making sure that surpluses to that find their way back to the Group on a timely basis. Certainly if you looked at Hong Kong, the HBAP, Hang Seng and China Bank they all have very strong capital ratios. We will continue to work with the teams and the regulators there to ensure that we are capitalised but surpluses are moved back to the parent company.

It is very true in the US. Absolutely nothing is different from what we talked about at the half year. Broadly, for the Group, as regulators around the world implement the requirements of Basel III, then we will be working closely with them and our business teams to ensure that we do not have inappropriate surpluses caught up in any of those legal entities, and we get them back to the parent to support the wider investment effort, dividends and, where and if appropriate, buy-backs.

**Tom Rayner**

At the moment you are 90 basis points above the top of that 12% to 13% range. Assuming Basel IV is neutral, which some regulators suggest it should be, does that suggest $8 billion in the kitty at some stage?

**Iain Mackay**

That would be quite a nice number to think about, Tom. You have changed your tune on Basel, have you not?

**Tom Rayner**

I did not say that was what I thought it would be. Some people suggest it might be.

**Stuart Gulliver**

It is worth Iain just pointing out that in the fourth quarter there is the bank levy and the provision for the final dividend, etc.

### Iain Mackay

That is absolutely correct. Tom, you are looking at 13.9% just now, which is a great place to be. As you well know, we have $1 billion and a couple of hundred million coming through in the fourth, which comes straight off of capital. The whole of the fourth interim dividend comes straight off of capital. There is usually a little bit of seasonality downturn in the fourth quarter. We certainly do not expect to see significant capital from Asia. If anything, we would expect to see the Common Equity Tier 1 ratio to come off a few basis points in the fourth quarter for those items. We have talked at some length about the surpluses that we have in subsidiaries around the world, and the capital management action we are taking is to get those surpluses back into the parent company and put ourselves in a flexible position to take the actions we think are necessary over time.

### Tom Rayner

Let me follow up on BoCom as well in terms of the commitment. My understanding of this change in regulatory treatment is that it is about the durable link concept, and therefore you are probably no longer committed to increasing, or even maintaining, your stake if BoCom, for instance, had a rights issue. Could you comment on what your long-term commitment is both to BoCom and to China expansion more generally, please?

### Iain Mackay

The second one is really easy, Tom. It is to continue to grow the business. We talked about this back in June last year. When you talk about PRD, we have had a strong business in China for many years, notwithstanding the fact that it is still only 0.2% of the total Chinese market. This is an incredibly important market to us, so we are going to continue to invest.

As far as BoCom goes, there is absolutely no change in our relationship. We have a strong commercial relationship. We own just over 19% of this. We have two directors on the board of BoCom. The change in regulatory treatment much more accurately reflects the nature of our relationship with BoCom and better aligns with the accounting treatment that we have out there. I absolutely would not read anything unusual into this change in regulatory treatment whatsoever.

### Chris Manners, Morgan Stanley

In terms of your 12% to 13% guidance range, what timeframe would you expect to get back to that range? If you do not want to do a big buy-back, is there potential that you could buy something if there are interesting opportunities out there for you? The second question is on the change in regulatory treatment. Obviously, you have discussed this with the PRA and they have given you an extra 100 basis points. Is there any risk here that they could change their minds and change the amount back again? It is something that not everyone was anticipating would move this way, and things can change. Are we sure that that is not going to be changed back at any point?

### Iain Mackay

Is there a risk that the PRA could change their minds again? To be honest, there is always that risk, but I think, in fairness, the PRA would only change that if we changed our attitude with respect to the investment in BoCom. As I mentioned, there is no substantive change in the nature of our relationship with BoCom, either commercially or strategically. I think this alignment very accurately reflects the accounting treatment and the nature of that relationship. I suppose that risk is always out there. I would think it would be very much informed by a change in HSBC’s attitude towards the investment, as opposed to anything else. In terms of the timeframe to get back into the top half of that range of 12% to 13%, the word ‘medium’ springs to mind.

### Stuart Gulliver

Obviously, there are a number of ways that we could migrate back towards that top end. Buy-backs, subject to regulatory approval, is one way, but nothing has really changed since the detail we gave you at the half-year. The stable dividend is another way, and so too is actually building the business. Increasing loans and advances would be a pleasant one to think about. If we got into a situation where we could start building back loans and advances with some pace, and putting on risk-weighted assets that are accretive, that would also use it up. The suggestion you made that we could make an acquisition is probably the least likely.

## Chris Manners

That makes sense. With this change, I suppose your return on required equity is actually going to go up quite a bit, and you're going to have a change in skew of where capital is allocated because you are having to allocate less capital to Asia, since you have a reduction in the BoCom capital absorption. To get to a more optimal mix and a more Asian skew, are you going to have to push harder into Asia again?

## Iain Mackay

We already have more than 60% of the profits derived from the Asian business. It does continue to be one of our most profitable businesses around the world. Under present trading conditions, it would not be an unusual place for us to want to allocate capital. I think that our goal for the balance between the global businesses and between the regions remains consistent with what we set out in 2015. I do not think this, to a very significant degree, changes the amount of effort of the allocation investment that we would need to do to accomplish that. Obviously more work needs to be accomplished between now and the end of 2017, but I do not think that this is, per se, a significant factor that would require us to adjust, in any dramatic way, what we are working on already.

## Manus Costello, Autonomous Research

Stuart, you mentioned in the presentation that the US principal business was not going to hit its target. I wonder if you might give us an update on what you think you might do with that business. Is it possible that we could see an RWA reduction in that area, given that you can now repatriate that capital? My second question is also about capital, I am afraid. Your Pillar 2A has gone up in the quarter. Is that just a result of the lower risk-weighted assets, or is that now your go forward Pillar 2A for the next 12 months? Did you know that the Pillar 2A was going to go up when you talked about being at the upper end of your guidance with the 12.5% to 13% because obviously that has somewhat reduced your management buffer?

## Iain Mackay

On Pillar 2A, that is the go forward number, and that is informed by the SREP review, which informs the individual capital guidance for each firm. That was very recently finalised by the PRA as it completed, I believe, the JRAD process with its European partners. That 1.6 covered within Common Equity Tier 1 is the go forward. It is obviously re-assessed every year, and we continue to take capital actions through our ICAAP to try and refine that. Notwithstanding the fact that it is finalised within Pillar 2A for 2017, there are a couple of areas where we continue to refine our data and debate the methodology with the PRA. That is the go forward number, and it is not influenced directly by the change in BoCom. Although we did not have it confirmed, based on the work that we did with the PRA earlier in the year on the ICAAP we had reasonable insight that this was going to be the outcome from a Pillar 2A perspective.

I will just talk about risk-weighted assets on the US business, and Stuart will give you more detail. As you probably noticed, we have been taking the risk-weighted assets in the US business down significantly. That has largely been informed by the disposal of the run-off portfolios of the US. We made more progress on that in the third quarter. We also set out here that we expect to have all of those assets off our balance sheet by the end of 2017. To the extent that we already have quite significant surplus capital within the US, that would create more surplus capital within the US. How we then deploy that capital will be informed by the CCAR process, as is the case for every bank that is subject to it in the US.

We are quite encouraged by the progress we made this year. We have more to do, and we will keep working away at that. There are clearly areas within the US business where the team has made great progress. They have made great progress in cost over the last couple of quarters. They have had a very tough year in terms of loan impairment charges this year, with higher loan impairment charges coming through, most notably in the oil and gas sector. There was progress on that seen in the third quarter, with lower loan impairment charges. But that was one of the key features of the shortfall in performance for the US business this year. We are moving the Retail Bank and Wealth Management more closely towards profitability, which is encouraging, but there is still work to do in each of the global business that are within the US, in terms of improving overall scale and profitability of the businesses.

## Stuart Gulliver

I do not have much to add, Iain summarised it well. We have the legacy piece to run down to zero, which is the old Household book. That will happen over the next couple of years. We then need a CCAR process to be able to dividend that surplus capital. In the meantime, we need to get much better returns in Global Banking and Markets and CMB. The team have done a really good job on costs, and their jaws are positive. The LIC is unfortunate because it is a US booked asset, as opposed to a geographic US LIC.

My expectation, therefore, is that we will get all of this achieved probably by the end of 2019 or thereabouts. What we have set as a target for the end of 2017 will be delayed by a couple of years. Part of the reason that it has been delayed is for the simple fact we had assumed that there would be some interest rate increases in the United States, which would give us a revenue lift and that would provide some revenue support to these tasks. Clearly, with interest rates staying lower for longer, that has not come through. That is why the other variable is that it will take us a couple of years longer to get there. You are absolutely right that we will have less capital than we have today in the United States, and less risk-weighted assets.

## Stephen Andrews, Deutsche Bank

I have one last question on capital and the 13% to 14% range. When you were setting that, did you have in your mind a 100 basis point capital relief from the change in the BoCom accounting? As you have rightly said, that does not change anything from a distributable reserve point of view. It does not change how much capital can get upstreamed from HBAP because it was already on this methodology. Surely, really, nothing has changed from a capital perspective for you guys in terms of your ability to either grow the business at the subsidiary level or, indeed, pay out a dividend. Should we really be thinking about your 12% to 13% range in new money being 13% to 14% or am I missing something here?

## Iain Mackay

I do not think that you should be thinking about 13% to 14%. Until guided otherwise by our regulatory authorities around the world, I think 12% to 13%, and the upper end of that range, is the right place for us to be. Cleary, having a 13.9% Common Equity Tier 1 ratio does have an influence. I will give you one hypothetical scenario, Stephen. The stress testing scenario will be announced on 30 November. We submitted results for that. We obviously know what we have submitted, and we are pretty confident about where we are from a stress testing perspective. Were we to receive an adverse outcome from the stress test, then having 13.9% at a Group level would clearly give us greater capacity to absorb any of that stress that may be coming through. As we all know, that is somewhat of a hypothetical exercise, but it does go to market confidence in the strength of the organisation, on a post-stress basis, to have stronger capital ratios.

What I really go back to is the response to the earlier question around the fact that we do have subsidiaries and that, as the local regulators build Basel III compliance at a jurisdictional level, we are holding very strong capital ratios at different subsidiaries around the world. One of our key focus areas between now and the final implementation of Basel III is to ensure that we are not carrying surplus to requirement capital in our subsidiaries as we are presently, for example, in the US. The reasons in the US are well understood and exceptional. There are a number of capital actions that we will continue to execute which puts the liquid capital resources at the Group level, which allows us greater flexibility around investment decision making or, if not then certainly the propensity to return that to shareholders, either in the form of dividends or buy-backs.

## Stephen Andrews

I just wanted to come back to the strength of Wealth Management in Asia. I think in the text you put it down to a favourable manufacturing environment in insurance. I wanted to push a bit on what you mean by that. We have seen a boom in cross-border life product sales as people are trying to move money out of China into dollars, which has recently been stamped down on as a result of the UnionPay stuff. Is that the sort of stuff where you were seeing strength like everybody else, which will now be a headwind, or was there something else going on in insurance?

## Iain Mackay

It was largely informed by a much more constructive environment in the equities markets, which supports the overall valuation of our business within the insurance. Certainly customer flow was more optimistic in the third quarter than it had been in the previous two quarters, but it certainly was not, to any significant degree, influenced by China flows, for example.

## Martin Leitgeb, Goldman Sachs

My first question is on structural change within the entity structure in Europe and whether you could provide an update on how you are preparing the entities here for both moving parts. One is obviously the ringfence in the UK. Secondly, and probably more importantly, how do you think about this structure excluding ringfence in Europe going forward, in light of the potential fall away of European Union passporting rights from here? Is your basic assumption that passporting might fall away and you try to consolidate most of the rest within, say, CCF, or is there an alternative structure that you are thinking of?

The second question is a brief follow up on your earlier comments on UK mortgages. I was just wondering whether you could steer us in the direction of what quantum of loan growth you are envisaging to achieve there, or what flow share you're aiming to achieve there. Some of your earlier remarks were that you have been substantially building up your intermediary networks, and I was just wondering whether we see that at full speed already in the third quarter numbers or whether there is a further scale up to come in the numbers in the coming quarters.

## Iain Mackay

Ringfence bank is moving ahead at pace. We are targeting to complete the ringfencing exercise in the summer of 2018. In terms of progress, I think we are very much on track at this point. There has been a great deal done, but the heavy lifting with respect to operations and technology separation will take place in 2017 and early 2018. That is where the bulk of the expense involved in that separation will take effect. There is no real change. This is obviously informed by UK legislation. There will be a non-ringfenced bank, which, to all intents and purposes, will be our Global Banking and Markets business in the UK that serves wider Europe. When you get into the licensing and passporting discussion, there is an advantage of having a well-established, full service, universal bank in France, which has all of the licensing and capabilities to support the product range, some of which we presently support out of our London platform. We have good flexibility both in terms of product capability, the platforms supported and human resources supporting that. Although we are not necessarily diving in right now to extensive re-planning of the work, we are certainly examining all of the alternatives available to us, and we will take action as and when there is greater clarity about how Brexit may impact the operations of the Bank. The focus, clearly, is to maintain the capability to support our customers. If that support capability needs to come from one of our subsidiaries in continental Europe, such as HSBC in France, then we would certainly have the capability to do so.

## Stuart Gulliver

On mortgages, the approvals market share third quarter was 8.4% compared to 7.2% in Q3 of 2015. We are nowhere near the steady state with intermediaries. We had 10 brokers on-boarded at the end of the third quarter and there are 13 additional brokers currently undergoing due diligence, of which a number will be cleared and on the platform by the end of 2016. No, you do not have the full impact of using intermediaries in the numbers yet.

Thank you, everyone. That brings the call to an end.