Transcript

Q3 2018 Earnings Release

Conference Call with Analysts and Investors hosted by John Flint, Group Chief Executive

29 October 2018, 7.30am GMT

Corporate participants:
John Flint, Group Chief Executive
Iain Mackay, Group Finance Director

John Flint, Group Chief Executive

Good morning from London, good afternoon to everyone in Hong Kong, and welcome to our third quarter results call. Iain Mackay will take you through the numbers shortly, then we'll field questions together. Let me start though by recapping our strategy and reflecting on our performance.

In June we outlined our plan to get HSBC growing again and create value for shareholders. To do that, we are delivering growth from areas of strength; turning around low-performing businesses; investing in revenue growth and the future of the business; and simplifying the organisation and investing in future skills. Central to this is our ability to use the revenue capacity of the Group to invest in the business, while maintaining good discipline around costs. Our third quarter results demonstrate our ability to do that, and to deliver on the promise to get HSBC back to growth. Our three main global businesses had very strong quarters. All three are increasing returns, winning new business, and investing in future capabilities. We see the potential for further growth, and we are continuing to invest to capture those opportunities. I'll now hand over to Iain to talk through our numbers.

Iain Mackay

Thanks John. Reported profit before tax of 5.9 billion dollars was up 28 per cent on last year's third quarter. Adjusted profit before tax was 6.2 billion dollars, an increase of 16 per cent. For the year-to-date, reported and adjusted profit before tax were up by 12 per cent and 4 per cent respectively on the first nine months of last year. Group adjusted revenue was 1.1 billion dollars, or 9 per cent, higher than last year's third quarter due to the strong performance of our three main global businesses. Third quarter adjusted costs rose by 2 per cent, reflecting our continued investment in growth and technology. We grew lending by a further 2 per cent compared with the second quarter, and 6 per cent from the start of the year. Our common equity tier one ratio remains strong at 14.3 per cent. The numbers also take into account the classification of Argentina as a hyperinflationary economy. I'll cover that in more detail later.

A quick look at some key metrics for the year-to-date: The return on average ordinary shareholders' equity was 9 per cent; the return on average tangible equity was 10.1 per cent; we had a lower tangible net asset value per ordinary share of 7 dollars and 1 cent, driven by foreign exchange movements. This was up by 1 cent from the second quarter. Earnings per share was 56 cents. For the first nine months we had negative jaws of 1.6 per cent. We remain on track to achieve positive adjusted jaws for the full year.

Slide 4 shows the items that take us from reported to adjusted. The principal difference with last year's third quarter is the absence of costs-to-achieve from our reported numbers. Last year's third quarter also included 104 million dollars of releases in relation to legal settlements and provisions. More detail can be found in the appendix. The remainder of the presentation focuses on adjusted numbers.

Slide 5 breaks down adjusted profit before tax for the year-to-date by global business and geography. Profit before tax increased in our four global businesses by a total of 1.9 billion dollars on the back of a strong revenue performance. Corporate Centre profit before tax fell mainly due to lower Central Treasury revenue and the impact of hyperinflation in Argentina.

Slide 6 looks at profit before tax for the third quarter, which was up significantly on the same period last year. Profit before tax grew in all four global businesses and three out of five regions, particularly Asia and Europe. The increase in Asia came largely from growth in transaction banking revenue in Global Banking & Markets and Commercial Banking, and from increased revenue from current accounts, savings and deposits in Retail Banking & Wealth Management. The rise in profit before tax in Europe was due primarily to good performances in the UK from Retail Banking & Wealth Management and Commercial Banking. In North America, higher revenue in both the US and Canada contributed to an increase in profit before tax. Hyperinflation in Argentina was the main cause of lower profit before tax in Latin America. This was tempered by the strong performance of our Mexico business, which continued to deliver double-digit balance sheet and profit growth. Our business remains well-balanced, as the breakdown by global business demonstrates.

Slide 7 shows the revenue trends in our global businesses. Revenue from our four global businesses was 1.6 billion dollars, or 12 per cent, higher in the third quarter versus the same period last year. I'll go through each business in more detail over the next few slides.

Slide 8 covers Retail Banking & Wealth Management revenue, which grew by 711 million dollars, or 14 per cent, compared to last year's third quarter. Higher balances and interest rates generated a 758 million dollar increase in deposit, savings and current account revenue, notably in Hong Kong. On the Wealth Management side, a 116 million dollar increase in insurance manufacturing revenue came mainly from higher new business premiums and actuarial assumption changes. Lending revenue fell by 181 million dollars due to continued asset margin compression from competition in local mortgage markets, particularly in Hong Kong. Customer lending rose by 8 per cent compared with the third quarter of last year, mainly on the back of continued strong mortgage growth in the UK and Hong Kong. Customer deposits increased by 3 per cent.

As slide 9 shows, Commercial Banking revenue grew by 479 million dollars, or 15 per cent, with growth across all our product lines. Global Liquidity & Cash Management revenue grew by 24 per cent on the back of higher balances and wider margins, notably in Asia. Credit and Lending revenue increased by 5 per cent thanks to balance sheet growth in all regions. Global Trade & Receivables Finance revenue rose by 3 per cent as we grew balances and market share in Asia and Europe. Lending grew by 8 per cent compared with the same period last year, and 2 per cent compared with the second quarter.

In Global Banking & Markets, revenue grew by 374 million dollars, or 10 per cent, compared with last year's third quarter, thanks largely to our strength in transaction banking. Revenue in Fixed Income, Currencies and Commodities grew 10 per cent on the back of a 39 per cent increase in Foreign Exchange revenue. This more than covered a 29 per cent fall in revenue from Rates. Securities Services generated double-digit percentage revenue growth, while revenue in Global Trade & Receivables Finance also increased. Global Liquidity & Cash Management revenue was 23 per cent higher due to increased balances and higher interest rates. Adjusted risk-weighted assets fell by a further 5 billion dollars in the third quarter. This included 6 billion dollars from the recycling of unprofitable client exposures, offset by business growth of 4 billion dollars. Additionally, there was a 2 billion dollar reduction in Market Risk due to lower volatility and changes in the mix of exposure. Return on average tangible equity was 12.5 per cent for the year-to-date. Our differentiated Global Banking and Markets business model continues to deliver for our clients and create value for our shareholders. Global Private Banking was broadly stable versus last year's third quarter.

Corporate Centre revenue fell by 439 million dollars compared with last year's third quarter. 304 million dollars of this was due to hyperinflation in Argentina. This cost was booked in the third quarter, but it reflects the year-to-date impact. You can find more detail in the appendix. Valuation differences on long-term debt and associated swaps resulted in a fall of 139 million dollars versus the prior year. We expect ongoing volatility from quarter-to-quarter. These differences would broadly reverse if the instruments are held to maturity. Legacy Credit revenue increased by 45 million dollars and included a gain on the sale of legacy assets in the third quarter. Our Balance Sheet Management full-year revenue guidance remains unchanged at 2.3 to 2.5 billion dollars.

Net interest income largely reflected higher deposit margins in the third quarter, rising 3 per cent to 7.7 billion dollars versus the second quarter. Group net interest margin for the year-to-date was 1.67 per cent, 4 basis points higher than for 2017. In the third quarter, we benefited from interest rate rises in Hong Kong, the UK and the US. Hyperinflation in Argentina reduced the year-to-date Group net interest margin by 1 basis point. You can find more detail on net interest margin in the appendix.

Slide 14 looks at expected credit losses and loan impairment charges. Expected credit losses of 507 million dollars related to Retail Banking & Wealth Management in Mexico and the UK, and Commercial Banking in Asia, Turkey, and the Middle East and North Africa. Higher expected credit losses in Asia reflected increased charges across a small number of customers, and also included an overlay relating to the possible impact of higher tariffs and trade restrictions. You will recall that, on the adoption of IFRS 9 on 1 January this year, we included a 245 million dollar overlay in the first quarter relating to UK economic uncertainty. Indeed, it is worth bearing in mind that expected credit losses remain sensitive to any changes in forward economic forecasts under IFRS 9. The credit environment remains stable and expected credit losses remain low.

Slide 15 shows our operating expenses in the third quarter. These were 155 million dollars, or 2 per cent, higher than the same period last year, and 161 million dollars lower than this year's second quarter. We continue to create the room to invest through a combination of cost discipline and revenue growth. We delivered 317 million dollars of cost savings in the third quarter, which more than covered the additional cost of inflation. The impact of Argentina hyperinflation brought costs down by 139 million dollars. As you can see from the detail on the slide, we invested another 338 million dollars in growth, digital and productivity, and regulatory programmes in the third quarter. We are on track to deliver full year positive adjusted jaws based on current operating trends. This is a discipline to which we remain committed.

Turning to capital, the Group's Common Equity Tier 1 ratio on 30 September was 14.3 per cent. Profit for the period of 3.9 billion dollars more than covered 2.1 billion dollars of dividends net of scrip, resulting in capital generation of 1.8 billion dollars in the quarter. In addition, there were adverse foreign currency movements of 1 billion dollars. Risk-weighted assets grew by 2.6 billion dollars on an adjusted basis in the third quarter. Loan growth was 2 per cent.

Slide 17 looks at our Group return metrics. The return on tangible shareholders' equity was 10.1 per cent. Our three main global businesses each achieved returns on tangible equity above the Group's target of 11 per cent, offset by the factors mentioned earlier in Corporate Centre. Our reported revenue as a percentage of risk-weighted assets rose by around 30 basis points to 6.3 per cent compared with the first nine months of last year.

I'll now hand back to John.

John Flint

Thank you Iain. As you can see, we are starting to unlock the revenue potential of HSBC. We are doing what we said we would – increasing revenue from areas of strength; improving returns; and investing in the business while keeping a tight hold on costs. We remain cautiously optimistic on global growth. Geopolitical concerns have softened customer confidence slightly since the half year, and are creating some volatility in capital markets. However, we are not yet seeing that impact core revenue streams in a meaningful way. Our balance sheet is growing, and provides us with a strong, secure revenue base. On top of that, our most significant external revenue driver in recent quarters has been the normalisation of interest rates. This is reflected in a very good set of numbers.

We'll move to Q&A shortly, but first I'd like to say a quick word about Iain. As most of you know, Iain leaves HSBC in December after 11 years, having done 32 sets of results as our Group Finance Director. In that time, Iain has been a terrific colleague and an integral part of the work that we've done here. He goes with the gratitude of the Group and our very best wishes for the future. We will now take questions.

Jason Napier, UBS

Good morning and thank you for taking my questions. Congratulations on what I think are, as you say, very strong numbers. Two, if I may. The first was, just looking at the composition of loan growth, sort of nine of the 15 billion dollars in loan growth was in the UK, whereas the Asian book is effectively flat, and it's obviously the area where I imagine the equity market expects longer-term growth. I wonder whether you wouldn't mind beyond the comments you've made around returns in Hong Kong being perhaps tougher, talk the prospects for better loan growth going forward and whether the current results are a function of risk-reward or pricing or what have you.

And then, secondly, just focusing on the UK as a driver of loan growth in the period, I believe the intermediary channel was about 40% of gross lending in the quarter, and that's probably about double, if our notes are right, where you were at the end of last year. So I just wonder, in terms of getting to an industry normal level of about two-thirds or more, what's missing? What's the outlook? Is it just time and training or is it perhaps price? If you could talk a little bit about the composition of that business, that'd be great. Thank you.

Iain Mackay

Jason, thanks very much. It's Iain here. So looking at growth in lending balances, on a year to date basis that's about 6.3% and Asia balances on a year-to-date basis are up about 7.5%. Now, truthfully, a considerable part of that was developed in the first half of the year, so the first two quarters saw very strong growth coming through our Asian businesses, notably within Hong Kong. The third quarter certainly has been a little bit slower, about 1% growth. That broadly is in line with seasonality that we would expect to see and that we've often experienced in the past – so nothing particularly concerning in that regard. And, as we said, strong loan growth, very much in line with the guidance and what we were expecting coming through the Asian business over the course of 2018 on a year-to-date basis.

I think overall, from a UK mortgage perspective, we continue to grow into that business, very much in line with an expectation that it would grow into what we would expect to be a natural market share, but, as you'll observe, the gross balances are developing at quite a nice rate. We're still sitting at around about 6.3-6.4% market share of stock in that particular area and maintain a very conservative risk appetite in terms of how we develop that market. And probably one of the key contributors to growth in that space is the expansion of our intermediate channel, which is an area we were barely present in just a little bit more than a year ago. That has grown very nicely over the course of this year, where we now have about 85% coverage for that channel.

Jason Napier

Just to follow up on that last point, so 85% coverage – I think you've indicated that that's almost as high as you're intending to go just cost-benefit wise. What is it that keeps you from being at around two-thirds of intermediary lending in the channel? Do you think you have to cut prices further?

Iain Mackay

No, I think we're still working on the development of the platform in actual fact. The platform was really introduced in November of last year, and we've still got quite a lot of work to do in terms of process improvement within that channel in terms of reducing cycle times and making the platform really work for the intermediaries. So it's just a question of continuing to develop that channel and work through it. I don't think there's any particular impediment to growth in that particular area.

John Flint

Just to add, I don't think it's our target to get to market norms of penetration. So you're right: 70% of the UK mortgage market is broker-intermediated; 40% of our flow came through that channel. We're round about the levels of penetration of the channels that we want to be at, but I don't think we're setting ourselves to get to 70% or market norms. In the short to medium term, I don't think we'll get up much above 50%. So it's not a target that we want to get to market norms, but it's good to see that we've made the progress we have with that channel.

Jason Napier

Thank you.

Iain Mackay

Thanks, Jason.

Raul Sinha, JP Morgan

Hi, morning. So, if I can have two please, just… The first one is on the impact of trade tariffs on your business as you've seen this quarter and how we should expect it to evolve going forward from here. If I look at the revenue line and impairment line, I was wondering if you might be able to comment where specifically have you seen any negative impact in the revenue line, if anything? And clearly in the impairment line I think you've talked about an Asia overlay. Could you give us some sense of what assumption changes you've made there that have driven the higher impairment and what sensitivity we should think about going forward?

Iain Mackay

And your second question?

Raul Sinha

The second question was on GB&M and its performance in the quarter. I thought it was really good. And I think you noted that FX were very strong, offsetting the weakness in Rates, up 39%. I think Credit was up 30%-plus as well. I was just wondering if we should – what we should be thinking about in terms of the sustainability of that, particularly the FX performance. Is there anything you'd call out there in terms of strength?

Iain Mackay

Thanks, Raul. I'll talk to the expected credit losses, and I'm sure John will give you more insight on what's happening on revenues as it relates to trade and tariffs. In terms of actual credit experience, we're really not seeing any impact coming through at this point in time at all, whether across retail or wholesale exposures, whether in Asia and perhaps more understandably in the United States. A very stable credit environment… The extent to which we saw credit costs coming through wholesale, specifically in Commercial Banking, was very much business as usual. There was nothing untoward in that, nothing singled out by an individual sector or marketplace – so absolutely nothing unusual when compared to previous quarters in that regard.

What we have done as part of the ongoing implementation of IFRS 9 is modelling with respect to expected credit losses in the forward economic guidance, which we revise on a regular basis. But our view coming through the third quarter was that forward economic guidance did not capture all of the possible impact on expected credit losses of trade and tariff restrictions. And as a consequence we provided an overlay of 71 million dollars – if you like, a management adjustment to adjust for the fact that we did not believe that the economic outlook fully captured all the forward-looking elements of that. So that's really what you've seen coming through credit costs in the third quarter specifically as it related to Asia.

John, any reflections on the revenue picture?

John Flint

Yes, there's nothing really in the numbers yet that is evidence of stress arising from the trade spat. So, as Iain said, nothing really on the ECL side but nothing on the revenue side that we can point to. Clearly, customers are a little bit more aware/anxious of the issues, so it's top of the conversations, but to date we haven't seen anything that's in the numbers. We're going to be publishing on Thursday a client survey, a customer survey we've done that speaks to the outlook for trade and business optimism. 75% of the 8,000 corporates that we've surveyed still have a positive outlook with respect to their own businesses and trade, and within Asia the number's even higher than that. So it's an obvious area of concern, but too early for it to be in our numbers.

Raul Sinha

Sure, thanks very much.

Iain Mackay

On GB&M, Raul, the performance in the third quarter, as indeed the case through the nine months of 2018, has been a good performance from Global Banking and Markets and a continued focus on driving capital efficiency. That combined with the revenue and profit performance drove a return on tangible equity for the year to date of 12.5%. We saw very good performances in Foreign Exchange; Credit also performed well in the third quarter.

And the one area which looked possibly unfavourable in comparison with our US peer group was the equities business. And I think that's largely informed by the shape of our equities business, where it's much more focused within the Asian business notably and consequent with the exposure to emerging-market equities, where… We certainly saw some compression in margins in the equities business, but also just I think, as we've mentioned, it was a slightly harder quarter in terms of emerging market equities in the third quarter. But across the piece, pretty strong in Global Banking as well – as well as Global Liquidity and Cash Management and Global Trade and Receivables Finance.

If you reflect back on the majority of previous years, we've always seen a little bit of seasonality coming through the fourth quarter, as it relates to Global Banking and Markets. Our revenue forecasts pick up on what we believe will be some seasonality. Clearly, the extent to which we have seen some volatility in the equity markets in the first few weeks of October would probably inform that that will reflect to some degree in terms of that fourth quarter seasonality.

Raul Sinha

Okay, but – so you wouldn't call anything out in the FX line particularly.

Iain Mackay

No, not at all.

Chris Manners

So, two questions, if I may. The first one was on the net interest margin and how things are going in mortgages versus deposits. When I look at page 21 of your slide deck, the mortgage revenue looks like it's down about 15% quarter on quarter and down about 30% versus where we were in Q1 2017 at about 450 million dollars. So I thought maybe you could talk about the mortgage trends and what that revenue line is quite so soft.

And then, on the flipside, deposits – very good. RBS were kind enough to tell us that they did a 40% pass-through in the UK from the rate hike that we just had. Maybe you could let us know how much you at HSBC had passed through to savers on the UK book. And then the second question was just on capital. Obviously, it's nice to see the Pillar 2A requirement come down there. Do you think that's a permanent step-down lower? And maybe you could help us think through about, you know, is that more volatility in that line or is that something you've done to reassure the PRA about your capital and we should just take 40 basis points off our steady-state ratio? Thank you.

Iain Mackay

As you know, the PRA are happy for us to communicate the change in Pillar 2A but not the composition of the change in Pillar 2A. I think what it is certainly very accurate to say is that the teams have worked very diligently over the course of the last two years to continue to provide a greater understanding as to how the Group manages risks that are not necessarily captured in Pillar 1. I think we've been successful over the course of the last two years through improving data quality, improving dialogue and understanding with the PRA in helping them understand the discipline around managing some of those risks, and that has resulted in the reduction that you see.

As you know, we're subject to an annual SREP review which focuses in on individual capital requirements as well as stress testing. As to whether or not that reduction proves to be permanent I think will be continue to be dependent on the Group's ability to demonstrate the discipline with which we manage these risks, continue to improve the quality of our data, continuing to improve transparency through our regulatory reporting, the stress testing, and the SREP processes, so great progress made. I'm afraid it's not really up to myself or John or the business to comment as to whether it's a permanent reduction, but it certainly would be our intention to continue to manage capital very diligently and in a disciplined manner to hopefully realise that outcome.

John Flint

And then on the NIM questions around deposits and mortgages, there's not a great deal to say. Obviously at this stage in the rate cycle this is what you would normally expect to see happen to margins. Our two big mortgage books are here and in Hong Kong, and both markets are very competitive. Clearly we have a structural advantage in both markets in that our cost of funds is different to the market's, but both markets are competitive and margins have been under pressure for some time. That's what we're seeing in the numbers.

With respect to the question around the pass-through rates in the UK, it's difficult to give a broad answer or a complete answer. On the retail side we passed through – at the last rate hike we passed through a little more than half, I think, to retail customers. On the wholesale side I don't have the number I don't have the information to give you an equivalent number to the RBS one.

Chris Manners

Okay, no, that's helpful. Thank you.

Ed Firth, KBW

Good morning, everybody. If you could come back again on the question of the savings numbers in slide 21, because there's obviously been a very strong performance there. I'm just trying to get a sense of how much of this is what I would call a sustainable uplift, and how much of it is a sense of the rates have just gone up, and therefore this quarter you've probably done particularly well because there may have been a delay of a month or a week and that we should see a slightly smoother picture going forward, or is that trajectory something that we should now be factoring in over the next 6 to 12 months?

John Flint

I think this story around savings is the story that has underpinned the revenue progression of the Group for the last few quarters and is likely to underpin the revenue progression for the next few, because we have these structural surpluses. They've been deployed reasonably short term into the financial market, and as monetary policy normalises the value of those surpluses reflates. It's really nothing more or less complicated than that, so if we believe that the Fed will continue to hike, and in particular if we believe that HIBOR/LIBOR will normalise, i.e. HIBOR will continue to track back towards LIBOR – as I think over time it will – then there is further upside in that line. It's nothing more or less complicated than we have surpluses which are now worth more now that policy rates go up. Those of you with a much longer term history of HSBC will recognise how quickly our margins compress when rates came off, from those crises, so this is just a reverse of that. If rates continue to go up from the Fed and LIBOR normalises there is possibly more to come.

Ed Firth

Okay. It's just that if I read the newspapers there seem to be signs of Prime Rate – some pressure on Prime in Hong Kong and perhaps savings rates are going have to be ticking up a little bit there if there's a bit more competition around. Is that fair or actually are you finding it pretty easy to hold your pricing where it is?

John Flint

No, that is fair. That is absolutely fair. I think the likelihood that we will pass more of future rate hikes onto customers than we did at the earlier stage in the cycle, I think that's absolutely fair. Yes, that's real.

Ed Firth

Okay. Thanks very much.

Joseph Dickerson, Jefferies

Good morning guys, just a quick one. If I look at your costs, which was 7.7 billion dollars in Q3 – there was a c. 100+ million dollar impact from Argentina – could you just discuss your investment strategy over the coming quarters? I think consensus expectations for Q4 have a fairly big 600-700 million dollar ramp-up in Q4, which strikes me as somewhat odd given where you are now and the walk that you've provided in the presentation. Any commentary on that would be helpful.

Also, in terms of your expected credit loss, you've called out the UK unsecured, but I note that the delinquencies are getting better there. Is this similar to the overlay that you did the trade? In other words, some caution around the UK that's management discretion? Any help on those two items would be great. Thank you.

Iain Mackay

Thanks very much for the question. You'll recall I'm sure at the first quarter we provided guidance that we would expect to see the cost profile for the remainder of the year impacted for constant currency to be broadly stable, with the exception of the point that you quite rightly identify in terms of the downward push from hyperinflation accounting in Argentina, which was 139 million dollars. That is precisely what we're delivering. Now, the commitment around delivering positive jaws is really that discipline around trying to keep the cost and investment profile in line with our propensity to generate revenue growth, which again we fully expect to accomplish for 2018 and beyond. If you reflect on page 15 the cost profile that you're seeing, I think we would guide you to something reasonably stable into the fourth quarter, obviously recognising that we'll have the bank levy to the tune of 1 billion dollars coming through in the fourth quarter, as we ever do.

Joseph Dickerson

Was that basically flat on Q3 ex bank levy assuming no major changes in currency?

Iain Mackay

Exactly. On credit costs, broadly as you can see from our numbers it's pretty stable. The increase that we're seeing coming through from unsecured is very much in line with what we're seeing of the growth in the unsecured business growing from a small base, whether it's in the UK, Mexico, Hong Kong or the United States. We're seeing slightly higher delinquencies in dollar terms, not necessarily in rate terms, on the back of growing an unsecured lending book.

In terms of reflection on the UK, we – when we implemented IFRS 9 on 1 January 2018, included within that implementation was our reflection that forward economic guidance at the time did not capture the full effect of the possible impact on the UK economy of leaving Europe. We incorporated an overlay at that time of 245 million dollars. That has remained consistent throughout the course of the year. There's been no adjustment upwards or downwards, and as we refresh the economic guidance going into the fourth quarter of the year we may see some movements either upwards or downwards in that degree, but really there are no other factors coming through credit costs other than those that we've identified. It's a very, very stable picture. I think one of the things that we saw was continued recoveries coming through the Global Banking and Markets business, notwithstanding the fact that they're slightly lower than in previous quarters. I think we're beginning to see some normalisation in these credit costs of levels we would expect.

Joseph Dickerson

Understood, thank you.

Fahed Kunwar, Redburn

Morning. Thanks for taking the questions. Just two. The first one is on the interest earning balance sheet you guys have provided in the quarter, which was very helpful. There's quite a big jump in the lending yield. I think it jumps 10 or 11 basis points in the quarter, just looking at the nine month versus the first half. Is that because of the effect of asset liquidity and HIBOR moving up? Is it inside that line or is there something else going on, because I guess it doesn't chime with a lot of the commentary around pressure and asset margins, particularly on the mortgage side of the business. That is question one.

The second question was on your risk weighted assets. Obviously you've had quite a decent sized currency benefit in the quarter, and if I exclude that then your risk weights basically grew in line with your lending and your leverage. Overall I think your target was for revenue growth in excess of risk weighted asset growth. Should we think about risk weights now broadly growing in line with the balance sheet, because over the last few years you've had very good capital efficiency, or is the effect of GBM optimisation still to come through on that point?

I guess a wider point here is on your Core Tier 1 ratio and your Pillar 2A reduction, you were talking about high 14, I think 15 being the Core Tier 1 requirement you want to go into going into Basel IV. Is that still the case? Should we still be thinking about capital build, or is the Pillar 2A offset mean you're comfortable around the level of Core Tier 1 you are at right now? Thanks.

Iain Mackay

Thanks, Fahed. No change to guidance on actually any of the points that you raised, whether it's with respect to Common Equity Tier 1, whether it's with respect to the rate of growth in the balance sheet versus the rate of growth in risk weighted assets. If you recall in June, John talked about mid-single or low-to-mid single digit growth on the balance sheet, and 1-2% growth in risk-weighted assets, so a continued focus on driving capital efficiency within the business. You'll have seen in these third quarter numbers continued progress in that regard, notably within the Global Banking and Markets business. I think the easiest response to a number of your question there, Fahed, would be no change to guidance that was provided when we updated the strategy in June.

In terms of overall yields, yes we have certainly seen improvement in yields both on the asset side and the liability side, as we've seen interest rates move up both in US dollars, the Hong Kong dollar related thereto, and also to some extent within sterling. That's very much as we would expect. In terms of both assets and liabilities, as we see the opportunity to invest surplus liquidity at slightly higher rates we're continuing to get good yield coming through that surplus liquidity position, but I think your observation is as we see higher interest rates we are seeing what we'd expect, both higher yields coming through in assets and in liabilities.

To John's comment earlier around depositor betas is obviously as we work through this rate increase cycle a slightly higher proportion of those rate increases are being shared with our customer base, whether in the UK or Hong Kong or other jurisdictions impacted by interest rates but certainly from a yield perspective we are seeing improved yields within markets affected by higher interest rates.

Fahed Kunwar

Just a follow-up on one of your questions; so we should expect the Core Tier 1 ratio to build going forward?

Iain Mackay

We said we would maintain Common Equity Tier 1 above 14%, recognising some of the matters that we still have to work through in terms of building understanding and clarity around what Basel III revisions and reform may mean. We indicated a number above 14%, and that's what we're sticking with.

Fahed Kunwar

Thank you very much.

Guy Stebbings, Exane BNP Paribas

Good morning. I just wanted to circle back on capital, and then a question on UK mortgages. On capital and Pillar 2A, I appreciate no change to guidance, but the gap now between your buffer and your capital stack is quite sizeable, so I appreciate the dynamics are particularly complex for HSBC given the structure with local RWA difference, double leverage considerations, not to mention Basel finalisation, but how should we think about a move in Pillar 2A? Does the makeup of your requirement limit the actual impact that any change in Pillar 2A actually has on the business?

Iain Mackay

Well, movements in Pillar 2A, particularly of the variety that we've experienced in 2018, are helpful. I think the regulation is quite clear: Pillar 2A requirements, or Pillar 2, are there to capture risks that our supervisors believe are not captured in Pillar 1. As we work through the reforms to Basel III, one of the things that I think the Bank of England has been quite clear and helpful on is that as they see those changes filter through Pillar 1 – so changes, whether to the standardised approach or the internal ratings based approach, for example – then there is an expectation that there would be some offset coming through Pillar 2. It's obviously too early in the day to see exactly how that filters through, but what we've accomplished this year is simply to realise through building improved how understanding of how we manage risk in this area, are some economies from a Pillar 2A perspective. It would be nice to continue to build on that. It clearly is an advantage in terms of building confidence around our capital management capabilities, both internally and clearly with the PRA as well. We'll build on that. I don't want to think – at this point it does not have a particularly telling impact on our capital guidance, as I just highlighted.

Guy Stebbings

Thanks. And then just on UK mortgages, obviously it's been an area of considerable growth in recent quarters, and again in Q3. Given the market is very competitive, how far away are we from a point where you would reconsider the amount of capital and liquidity you're deploying into the UK mortgage market, or do some of the favourable dynamics on the deposit side offset that, and you're happy to continue to grow at the current level?

John Flint

We're still happy to grow into a UK mortgage market. We've been absent from a big part of it for such a long time; we're really just stepping back into it. Our market share in mortgages are still less than half of our natural market share on the liabilities side of the balance sheet, so they're still very much, if you like, underweight. There are still plenty of good risks for us to take in the UK. Post the structural reform we do have capital and funding to deploy back into the domestic economy; it's one of the by-products of the structural reform. We're happy to continue to do this; we're not changing our risk appetite. We'll stay disciplined, but there's still very good business for us to write. Whether we grow as quickly as we did in Q3 I don't know, but we should continue to take back some of the market share that we gave up in prior periods.

Guy Stebbings

Okay, thanks.

Ronit Ghose, Citi

I have three sets of questions please, if I may. The first one is can I circle back to your strong GBM performance? I've obviously heard what you've said so far on the call, but is there any more colour you can give us on your FICC performance in particular? Is there any colour on either client activity, whether it's FI versus corporates, positioning went well? The only reason I'm following up is that it's pretty broad-based; it's FX, on a quarter-on-quarter FX rate and Credit, and if I look at the trading line in your P&L this looks like it's the best quarter since early 2016. You seem to have capitalised on some of the EM volatility. Any colour around that would be great. Shall I go onto my next two questions?

Iain Mackay

Fire away.

Ronit Ghose

The second question is on RBWM. I'm looking at page 21 of your deck in the appendix, and by the way, in the last couple of years your disclosures have been really helpful, so thank you for those. But page 21, where you split it out, and I can see the strong performance and savings which you've talked about are partly offset by the loans pressure. Can you comment a little bit more on the life insurance line, the manufacturing? I was kind of taken by surprise at the 100 million dollars quarter-on-quarter improvement in life insurance manufacturing. I just felt given the soggy markets – particularly in Hong Kong where much of this must be booked – I thought that would have gone down rather than up, quarter-on-quarter. The other line in RBWM is up, also quite substantially. That is my second question.

The third question is how do you think about Argentina and the hyperinflation accounting? I know you've said about year to date the negative impact that you've booked, but looking at FX movements it looks like a lot of the FX movement in the piece have happened during the third quarter. Is it fair to say that much of that impact is third quarter, or should I be thinking about it spread across the year in a quarterised – that negative you've booked? Thanks for taking the questions.

Iain Mackay

How about we do those in reverse order? The requirements of IAS 29 and 21, the two go together. There's no judgment involved; there's a set of criteria that we have to apply. We have applied those on a year-to-date and inception-to-date basis. We're required to disclose current purchasing power by reference to the index. We've disclosed in the earnings release the index that we've applied. The net impact of 145 million dollars on PBT is inception-to-date impact. We're required to do this every quarter. In actual fact, the standard is quite rigorous in that regard so there may be an adjustment in the fourth quarter, but we would expect that to be in the low 10s or even less, in terms of any impact on PBT in the fourth quarter. Now, when you've applied the purchasing index to the Argentinian data you're then required to translate that into US dollars for Group reporting purposes at the end of the reporting date, so the 30 September date was applied. That clearly amplifies, based on current movements, the impact that

that then has on PBT. So to be clear, we're not restating prior periods; there's a total catch-up of 145 million dollars on PBT from hyperinflation accounting. There may be a small adjustment of that in the fourth quarter. Obviously we'll keep you posted in that regard, and that's about it really.

John Flint

Shall I have a crack at the life insurance one? So life insurance – so the way that we account that, you'll be familiar with the PVIF accounting. Any changes to market or economic assumptions, changes in the value of equity markets or bond prices etc, they transmit through the P&L on a monthly basis. Any market stress, you will see in the P&L on a monthly basis. However, there is an annual exercise which we conduct in September where we update what we call the non-economic assumptions; if there are any changes to models, any changes to things like longevity across some of the parameters that I can't remember. We do that on an annual basis in September. I think last year it was a negative; this year we've indicated that it was a positive adjustment of 88 million dollars in the third quarter. It's that; it's this annual non-economic assumption adjustment that we do every year.

Iain Mackay

In that 'other' line – also Ronit – there was a negative adjustment in a prior period which impacted the 'other' line within Retail Banking and Wealth Management, and it's a little bit of a conglomeration of odds and sods as it relates to the Retail Banking and Wealth Management business. There's nothing particularly telling in the 'other' line as it relates to Retail Banking and Wealth Management.

Going back to Global Banking and Markets for a little bit more colour, we've always tried to make this point that this is a well-diversified business which is not particularly dependent on the strength of any particular business in any particular quarter, and hopefully you can see again from the disclosures on page 10 within the investor deck, as well as those within the earnings release, that this is a well-diversified business. Within the Fixed Income, Currencies and Commodities space you've seen a very strong performance in the third quarter from Foreign Exchange. Credit came along quite nicely. Rates again we saw has been quite weak, and that's been a continuing phenomenon over the course of the last two quarters. I think the one point that would perhaps stand out when compared to the American peer group is that Equities seemed a little bit weak, and that almost certainly goes to the composition of our Equities business, with stronger concentration within the emerging markets and Asia in particular; where Equities performance, both in terms of margins and the prime business and overall flow in the third quarter was probably more difficult in emerging markets than was the case in the United States, for example.

Again, we saw a pretty stable picture within Global Banking; Global Liquidity Cash Management moving ahead strongly at 22%, Global Trade and Receivables Finance, again another strong quarter. This is a broad-based business which is very much focused – a preponderance of focus on corporates as opposed to financial institutions. Again, that's an observation that we've made in the past that the business is very much focused on a corporate customer base with a much higher proportion of corporates as opposed to financial institutions when compared to some of our peer group.

Ronit Ghose

And Iain, just a follow-up on that comment, has there been a notable pickup in corporate activity in FICC, like hedging or other in the third quarter? Is that what's helped you? I'll put you in contrast with some of the big global banks that have reported. Some reported good FICC results, but this looked particularly good to my amateur eye.

Iain Mackay

I think that's true, but I think the other areas within FX there was fairly sensible positioning done ahead of time within the emerging markets, recognising some of the pressures that were coming through in that particular area. Our business and our results for business tend to be a reflection of how corporates are positioned as they see trading conditions develop in front of them. That would be true both in the case of Foreign Exchange as well as within the Global Banking business.

Ronit Ghose

Okay, thanks for that, Iain. Thank you for all your help and good luck in the new role.

Iain Mackay

Thanks very much, Ronit.

Manus Costello, Autonomous Research

Good morning, everyone. Just two quick ones from me. You previously called out that you thought that US dollar deposits outside the US were seeing upwards pricing pressure. I just wondered how that developed during the quarter, and whether you're a bit more relaxed about the outlook now as rates continue to go up even further in the US.

My second question is on your pension. You call out the fact that the recent judgment against Lloyds means that you're going to have to likely take a charge as well. Can you give us any indication of how material that might be, please? Thank you.

Iain Mackay

In terms of eurodollar liquidity, I think it would be fair to say that there has been building over the last quarter or two some pressure just in terms of eurodollar liquidity, almost certainly informed by the fact that a number of central banks are beginning to ease off, or reverse, quantitative easing. As a consequence of that you can certainly see slightly higher funding costs coming through in the euro/dollar space, but again, nothing particularly of note in the third quarter, just an observation that liquidity in that space is tight. Again, when you look at the strength of our corporate surpluses in our main operating centres around the Group, this is something that we – overall, the improving interest rate environment for us is a very positive tailwind. Just as an observation around euro/dollar liquidity, that is tightening.

Manus Costello

And do you think that beta for you would be about the same as it was at the half-year, or has it increased versus the half-year?

Iain Mackay

Very, very marginal increase. In terms of the judgment handed down by the High Court in respect of Lloyds Banking Group on Friday, as you know that will affect a great many defined benefit plans across the United Kingdom. Our largest defined benefit plan in the world is the UK defined benefit plan. It is very well funded; we carry a surplus on that plan of some £6.2 billion. The effect of that judgement will be that will sit down with our actuarial team and go through and work through the impact of that judgement on the plan, but it will result in us recording a charge to the P&L in recognition of prior period service. This is a cost of service from our employees in prior periods. We'll evaluate that. It will not be – well, I shouldn't say it won't be, because we're working through the valuation of it, but in the realm of significant versus material we would expect it to be significant but not material, if that makes any sense to you at all.

Manus Costello

I think I'll follow up with IR on that afterwards.

Iain Mackay

You can follow up all you like; they've been told they can't tell you anything until our team's finished the work.

Manus Costello

Alright, thank you very much.

John Flint

Manus, thank you. I think it looks like we've got one more question and then I will sum up. We'll take the last question.

David Lock, Deutsche Bank

Morning, everyone. Thank you for taking the questions. First one is just on model changes. I think, Iain, you've previously called out 12 billion of opportunities in the second half. I just wondered if you could give us an update of where we are and the likely timings of those.

The second one is on Global Trade and Receivables Finance. If I could compare the funded assets which are in the slides with the revenue trends, it looks to me like the margin has actually jumped from about 80 to 90 basis points in the third quarter. I just wondered if that's a real increase you're seeing in the margin there, or if that's just an averaging effect in the balances that I can see on the slide.

And then the final one is another question on slide 21. I think you've restated the way you split Holdings' interest expense and other. I just wanted if you could give us a steer on how we think those lines should evolve over time. I think you've previously talked about 0.2 billion dollars of MREL increase coming through this year versus last year. Could you give us an idea of how we should expect the fourth quarter and 2019 to evolve? That would be great. Thank you.

Iain Mackay

In terms of any further issuance in the fourth quarter, I think it's going to depend on the market. We've largely looked at an AT1 and an MREL level, completed what we set out to do for 2018. We had pretty favourable funding markets for HSBC product over the course of this year and as recently as the third quarter. If the market is equally welcoming of HSBC paper, we may well go ahead and try to prefund some of what we believe we would need to do or we know we would need to do in 2019, provided the conditions are favourable to us. If we were to do any more in the fourth quarter, it would probably be in the range of 2-3 billion dollars in the MREL space and across a range of currencies, other than the US dollar.

Really, what we did within that classification was to split out to give you more of a headquarter cost view, in terms of what is retained at the parent company, in terms of our holding company capital buffer, in terms of funding and refinancing requirements for that debt. You know the principal issuer of instruments is the holding company, so we're just ensuring that we have a strong refinancing buffer there to mitigate any refinancing disruption. Really, nothing else on that front.

When you talk about the Global Trade and Receivables Finance, we've certainly grown the revenue in that regard. When you talk about margins, we've seen a little bit of expansion in margins – and when I say 'a little', I mean a little – in the European context and a little bit of tightening of margins in the Asian context. Broadly, what you're seeing across the Global Trade and Receivables Finance as a whole is a bit of an averaging effect, with a little bit of expansion in Europe, offset by a little bit of compression within the Asian environment.

You talked to model changes. We do; we started with the year with about 20 billion dollars of opportunity for model approvals from the regulator. In the first half of the year, we got 8 billion dollars of that through. We've got about 12 billion dollars still to come. Whether that is going to come through in the fourth quarter, I would hasten to say is probably unlikely. Our model approvals require approval from the EBA or the ECB as well and, in that regard, we've, along with probably other banks in the UK, fallen slightly victim to the Brexit process, such that, notwithstanding the best efforts of the PRA, there are a few models that have not yet been approved and probably will slip into next year. We continue to manage down risk-weighted assets in Legacy Credit and what we've got is a very small runoff in the US portfolio, which is principally operational risk-weighted assets, which we'd expect to see roll off progressively over the course of the next year or so. The discipline around overall RWA management, no change in that regard. There's a strong focus on continuing to improve the overall efficiency of the capital deployed within the businesses, the Corporate Centre and the Group overall.

John Flint

Thank you all very much for joining us this morning. Just as a quick recap, a really solid set of numbers for Q3. Management's primary focus is on improving the return on tangible equity of the group and getting us back above 11% by 2020. In order to do this, we plan to grow revenues quicker than costs and this is why our positive jaws discipline is something to which we remain committed. I was expecting lots of questions on jaws this morning and we didn't get many, so it suggests that you're comforted by the progress we've made in Q3. As I say, we remain in line with our plan to get back to positive jaws. As I indicated at the half-year, I won't make any silly decisions that damage the long-term health of the franchise just to get there. Positive jaws is the means to the end. The end is a much-improved return on our equity but, again, Q3 should give you comfort that we're making good progress against the strategy that we outlined over the summer. Thank you for being with us. Operator, this ends today's call.