Edited Transcript

Commercial Banking – Investor Update

Meeting with Analysts hosted by Simon Cooper, Chief Executive, Commercial Banking

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Corporate participants:
Simon Cooper, Chief Executive Officer, Commercial Banking
Kathleen Gan, Chief Financial Officer, Commercial Banking

Simon Cooper, Chief Executive Officer, Commercial Banking

Good morning, everybody. Welcome to this investor update on Commercial Banking. I'm joined this morning on the call by Kathleen Gan, who's the Chief Financial Officer for Commercial Banking, known to many of you.

What I want to do this morning is to take you through the financial highlights from the first quarter, both at a Group level and obviously in Commercial Banking. Then I'll provide some context for the rest of 2014 by talking about the external outlook and how we're driving the business. After the presentation, there'll be certainly a chance to ask questions.

So, as we move through the usual disclaimers, I really want to start with a very brief summary of our first-quarter Group results. These next two slides will be familiar to those of you who were on the results call with Stuart and Iain. Underlying profit before tax down by $1 billion on the first quarter of last year, largely the result of a number of significant items that benefited the previous year's first-quarter results. Alongside this, return on equity was 11.7%. We maintained a tight grip on costs. The advances-to-deposits ratio was well below our 90% cap, and our capital position remains strong.

The next slide shows the reconciliation between reported and underlying profit before tax, and adjusts for movements on the fair value of our own debt, the key transactions which we've broken out for you, and their operating results, together with foreign currency translation differences.

Moving on, now, to global business revenues, the left-hand chart shows that, overall, global business revenue was down by $350 million, or 2%. There were declines across a number of businesses and books, which were partly offset by revenue growth in Commercial Banking of $199 million. This growth was primarily due to higher net-interest income, mainly in Asia, from average balance sheet growth, and in the UK, from a rise in deposit balances and wider lending spreads. In addition, we benefited from increased collaboration with Global Banking and Markets, notably in Asia, and from higher term-lending fees in the UK.

Turning to the financial highlights within Commercial Banking, as you can see on the right-hand side, all of the key metrics were up on the first quarter of 2013. Underlying profit before tax grew by $0.5 billion in the first quarter of 2014. While costs were down on the previous year, I would draw your attention to the increasing costs in the first quarter compared to the trailing quarter. This largely reflects the necessary investment in global standards, and also in Risk and Compliance.

Finally, total product revenues across Commercial Banking also grew when compared to the same period in 2013, but fell compared to the trailing quarter, which was partly driven by exchange-rate movements and the gain from the Panama disposal, which was booked in the trailing quarter.

So, having looked at the first-quarter results, this slide covers the external outlook for 2014. Commercial Banking delivered balance sheet growth year on year, and continued growth in the first quarter. Overall, however, the picture is mixed, and clouded by economic, political and regulatory uncertainty. While it's true to say that there are some encouraging signs in the global economic environment, with global GDP forecast to return to growth in 2014, we fully expect that the external environment is going to remain challenging. We experienced continued muted customer activity in April. I'm sure I don't need to remind anyone on this call of the uncertainty that exists across the world right now.

Despite these prevailing operating conditions, two areas where we have demonstrated resilience are in spread compression and in loan impairment charges. Compared to the trailing quarter, total asset margins remained flat, which trade margins stabilised in the first quarter, after a period of compression in 2013. The lower margins are the result of looser fiscal and monetary policies in developed markets like the US, which have supported economic recovery by increasing market liquidity and credit availability. Loan impairment charges in Commercial Banking were down significantly in the first quarter, reflecting lower specific impairments, mainly in Mexico, Brazil and the UK.

Many of you will have seen this slide before, but I wanted to remind you how we're structuring the business to meet our customers' needs and to drive returns. I think the key point from this is that Commercial Banking is being run as a global business. While, in the past, it operated on a geographic basis, it is now run through the global segments of business banking, mid-market and large corporates, with global product coverage which enables us to achieve greater consistency, to increase transparency and to mitigate risk.

I also want to highlight the fact that the other box, on the right-hand side of the product view, includes our collaboration revenues. Since 2010, we have delivered $1.3 billion of incremental gross revenue, as a result of collaboration, and, most notably, we've seen that in strong sales of Global Banking and Markets product to Commercial Banking clients.

Over the next few slides, I will go into product revenues in more detail, starting with credit and lending. The first quarter saw a marginal growth in asset balances, having been flat across the trailing quarter. Specifically, term lending grew both year on year and in the first quarter, and this was mainly attributable to Asia. Compared to the first quarter of last year, we also saw a greater market share of new term lending in the UK. This is based on data from the Bank of England, which shows that HSBC grew faster than the market from the start of the year through to March. UK Commercial Banking captured 8.1% of new lending in the market in the first quarter. That compares to about 6.5% in the same period of last year.

Moving on, now, to global trade, I think this slide paints a fairly consistent picture to previous presentations that we've shown you. The graph on the left shows that global trade remains broadly flat. In fact, the WTO has now revised its growth forecasts for 2014 down from 5% to 4.5%, and, just to put that into context, if you look at the period from 1982 through to 2012, the average annual growth was up at 5.4%. There's, therefore, been considerable competition for current trade flows, which has led to significant margin compression across the industry. While we have seen margins stabilise in Asia, we've managed to offset the impact from other markets through double-digit growth in trade assets, and this has protected our revenue.

In payments and cash management, we saw growth in liabilities balances year on year, but these were flat compared to the trailing quarter. We have succeeded in winning new customer mandates, and our payments volume increased by 4% year on year, generating additional fee income. We also continued to migrate customers to digital and mobile payment platforms. Over $34 billion of mobile payments have now been authorised.

So let me, finally, sum up with our investment priorities going forwards. On the product side, I've already spoken about trade and cash management today, so I want to highlight the investment we're making in upgrading our collaboration with Global Banking and Markets. As I said, we've delivered $1.3 billion of incremental gross revenue by collaborating with global businesses since 2010. A large part of that is with Global Banking and Markets, and, within that, largely from foreign exchange. This targeted investment in foreign exchange will, in turn, accelerate our global leadership position in RMB as the currency continues to internationalise.

If we look at segments and geographies, we intend to enhance our strategic relationships with global large corporate customers and build out our corporate franchise in markets such as Germany and the United States. In the mid-market, we will strengthen our franchise in six scale markets: the UK, Hong Kong, the US, Canada, Brazil and Mexico, and we'll expand our international relationship management model in business banking, focusing on 12 priority markets.

Ladies and gentlemen, that concludes the formal part of the presentation, but I would like to now open up the lines to questions that I, alongside with Kathleen, will seek to answer.

Manus Costello, Autonomous

Good morning. I have a couple of questions, please, actually. Firstly, just on your balance sheet usage, I know that Commercial Banking is highlighted as the area that HSBC wants to focus most of its incremental capital allocation towards in the future, but, if I look at your use of the balance sheet versus the revenues you're generating from the balance sheet, it does look as if your RWAs are continuing to tick up, but, as you pointed out, Simon, I think you've had to deliver double-digit growth in balance sheet to try and defend the top line, because of margin pressure. So I guess the question is: at what point do you feel that you're not going to get the right revenue return, even though you're being given lots of incremental capital from the Group to play with, and then when will we start to see credit and lending actually start to grow in terms of revenues?

My second question is: you highlighted FX as an area of collaboration with GBM. Is there much collaboration in rates as well, or is that much smaller than FX? Thank you.

Simon Cooper

Manus, thank you – great questions. I should also thank you. I understand you're responsible for the quality of our data pack going out, so good going on this as well. If you start about balance sheet usage, and we reflect back on the asset growth we've seen, when you look at total loans and advances to customers, they've gone up by about just over $4 billion in Q1, so that's about 1%. When you look geographically at where that's distributed, mostly in Asia, and also in North America.

I think you've also got to then break out loans and advances to risk-weighted assets. You've seen a risk-weighted asset increase since the fourth quarter of 23 billion. Obviously, there's regulatory pressure on risk-weighted assets that we continue to reflect in our numbers.

Manus Costello

Sorry just to interrupt, Simon. How much of that uptick, Q4 to Q1, was CRD IV driven, and how much was other things like the changes in risk levels and things like that?

Simon Cooper

As you know, unfortunately, we don't disclose the split that way, but what I was going to come on to say, really, is, in terms of returns, and I think, as you've seen with the collaboration numbers, there's great opportunity to continue to use the credit and lending product to drive returns, so some of those revenues sit in the Commercial Banking business. Some of them, obviously, also sit in the Global Banking and Markets or Private Banking or Retail Banking and Wealth Management line of business, so there's a difference between how we present results to the market, but, looking at the customer view, which is how we're managing the business, and obviously we are mindful to make sure that we are generating customer returns in excess of our cost of equity and continuing to drive that forward, and I see that as a key driver that we're using to drive the business.

In terms of the second part of the question, which was on the split of where we're getting collaboration, by comparison to FX, the volume of income attributable to rates is much smaller. What I would say – and I think it's important to look into league tables and market positioning – when you look at our market share in debt capital markets, particularly that related to Commercial Banking clients, then I think we're starting to see a significant uptick in terms of our positioning and in terms of deal flow. So I think we are not just driving revenue, but we are able to drive market positioning, and, from that, greater cross-sell.

Manus Costello

Okay, thank you.

Simon Cooper

I think, just to give you some stats, I think, if you look at international bonds, we've gone from five to one across Bloomberg.

Manus Costello

That's great. Thank you very much.

Simon Cooper

Thanks, Manus. I think we have a question in the queue, operator.

Raul Sinha, JP Morgan

Hi, good morning, Simon. It's Raul Sinha from JP Morgan here. Apologies, I was logged into the webcast, and I just realised I had to switch my line to ask a question. I was just wondering if you could potentially expand a little bit on your margin comment and talk a little bit about the outlook for trade and cash margins as you look across HSBC's geographic split. Particularly, I'm interested in the moves in margin that you were seeing upwards in China-related business. How sustainable do you think they are in the short and medium term?

And, then, if you can talk about whether you're seeing any kind of withdrawal from this business as well from other competitors, that would be interesting, and, then, secondly, if you can talk about other geographical areas where you're seeing some uptick in margin or not. Thanks.

Simon Cooper

Raul, thanks for the question. I mean, obviously margin pressure was the theme of discussions throughout last year, and, if you look on a consolidated basis, we are still seeing some margin compression, but, if you look at Asia, actually, we've seen that compression slow. We haven't yet seen, across the book, that turn to margins going up, but we are starting to see, for some clients, the ability to re-price trade upwards, so I think, in Asia, it's early days, but some positive signs. Where we're not yet seeing that margin compression flatten out is in Latin America, and, obviously, although QE is slowing on a global basis, the volume of liquidity flowing into the market is still increasing, albeit at a slower rate, so I think there is some monitoring we need to do of the liquidity position.

In terms of withdrawal from the China market, I don't think we've seen people withdrawing from the market. What we have seen is that, given the footprint that HSBC has globally, we've been able to capture, I think, an increasing share of business with China, and, given our focus on RMB, I think, as the RMB internationalises, I would expect HSBC's share to continue to increase.

Raul Sinha

If I can just follow up, Simon, on that, is there a regulatory headwind that you foresee, perhaps not for yourself but in general for the industry and for some capital-challenged competitors, relating to the amount of capital that goes into trade finance, eventually, in the long term, driven off from changes related to Basel III?

Simon Cooper

I think there's obviously review of models and risk-weighted assets on the back of models that we continue to review. I can't give you a specific headwind and a specific direction of that headwind, but it is true to say that regulators continue to look at models across our and our competitors' business.

Raul Sinha

Alright, great. Thanks very much.

Martin Leitgeb, Goldman Sachs

Hi. Just a quick follow-up question with regards to revenue, and obviously the outlook for this year. You mentioned that, last year, you experienced, obviously, the margin compression, which was offset by very strong volume growth, and I was just wondering if you could shed a bit of light on what kind of volume growth in transactional banking, trade finance, we might be looking for this year.

Simon Cooper

I think you'll probably get me fired for giving a profit forecast if I gave you that level of detail, but I think what we can say is that we've continued to see double-digit growth in trade volumes, and we've continued to see some uptick in our liabilities business, which continues to be a focus for the cash-management business.

Martin Leitgeb

Okay, thank you very much.

Simon Cooper

Okay, I think that brings the call to an end on that basis. Thank you all very much for joining and taking the time out of a busy schedule. I hope to see you all soon. Thanks very much.