H1 2022 Post-Results Equity Analyst Meeting

31 August 2022, 8.00am BST

RICHARD O'CONNOR, GLOBAL HEAD OF INVESTOR RELATIONS: Good morning and good afternoon, everybody. We have a good attendance here in London from the analysts, so thanks very much for attending in person and for this rearranged analyst meeting, mainly for the London analysts to ask questions. We do have the Hong Kong analysts on the line as well, but we'll prioritise the London analysts for the first 40 minutes or so. As I say, we've got a number of people on Zoom. What I intend to do is probably do five or six from the floor here. Mark or I will then check who's raising hands and shoutouts, to have the people on Zoom, and then we'll go back to making it an interactive discussion. With that, over to Ewen.

EWEN STEVENSON, GROUP CHIEF FINANCIAL OFFICER: Hi. Look, apologies again for our technical issues in Hong Kong a few weeks ago. We've also, down the end of the table, Carlo Pellerani, who's our Group Treasurer, and Jonathan Bingham, who's our chief accountant. I wasn't going to do any introductory remarks, but just open it up for questions.

RICHARD O'CONNOR: We've also got Ming Lau, our Asia CFO, and Kathleen Gan as well, who we may ask to answer questions. Who's going to ask the first question from London? There's mics that will come round, if you give your name and institution that'll be great.

GUY STEBBINGS, BNP PARIBAS EXANE: I just want to ask around the mortgage market in Hong Kong and how you see risks in that market in the context of – in the past you've said you think it's unlikely to materialise any losses. If you look at the ECL provisions against the balance sheet there, it's negligible, and that doesn't change under a severe downside scenario under IFRS 9. If you go back over a long period of time for Bank of England stress tests, you get to very high losses but under very aggressive assumptions. I just wondered, is there some sort of scenario between your severe downside and prior Bank of England stress tests where there is a biting point, where you would start to see losses come through? Any context you can give around that? Maybe what the mortgage insurance quantity is around the portfolio? Any detail or colour would be very useful.

EWEN STEVENSON: Ming, do you want to start on that?

MING LAU, CFO ASIA-PACIFIC: Sure, Ewen. The point I would draw out on the mortgage book is strong LTVs. The average LTV in the book is less than 50%, so it would have to take a pretty severe downturn in terms of property prices before you incur losses in that book overall.

To the point on mortgage insurance, I don't have the specific number with me. I can get Mark to come back to you on that, but I think generally my view on it at this point is unless there's a severe correction above 50% on property prices I wouldn't expect any severe losses in that portfolio.

EWEN STEVENSON: Presumably, Ming and Jon, you can just look at our IFRS 9 modelling and you'll see various scenarios there if you want estimates.

JONATHAN BINGHAM, CHIEF ACCOUNTING OFFICER: If you look at page 74 of our Interim Report you'll see we do the Hong Kong mortgage portfolio under the various scenarios, and even in Downside 2 we struggle to get anything that hits the roundings. You do need that very dramatic HPI reduction to move that book.

RICHARD O'CONNOR: One thing I would say is that you've seen prices fall this year, but very much in line with our expectations and our economists' expectations. We think the market is saying there may be another 5% or 10% fall from here. We've seen that in the past, and the market's quite weak at the moment, but the trends in the last few months have not been outwith our expectations.

RAUL SINHA, JP MORGAN: Could we go to capital? Obviously the second half of this year is going to have quite a few moving parts, and you talked about the hedging changes that you've

made. Obviously the market since then has shifted again from a rates outlook perspective, so I was just wondering if you've got any thoughts on how we should think about whether you might need to do any more hedging, firstly, around the capital impact from OCI?

Secondly, related to the market moves, sterling has been again quite weak in the third quarter. Any particular thoughts around how that impacts capital, whether you still have a hedge on the sterling element of your equity base? I think you're overcapitalised, so whether or not that has any impact in the third quarter relative to what we were thinking about a month ago.

EWEN STEVENSON: I can start off at a headline level and then maybe Carlo can say a few other things, but we said at Q2 results that we expected common equity tier 1 to be approaching 14% at the end of the year. That's still very much in line with what we think as of yesterday.

CARLO PELLERANI, GROUP TREASURER: I would just remind you of the headwinds that we had mentioned. There is of course the headwind for the France sale and there is another five basis points or so of other M&A. In terms of FX, in the last quarter we had about a 10 basis points hit through FX on the back of the movement in currencies, so that type of magnitude is always possible, given what we have seen so far.

In terms of hedging I would just remind you that we need to balance the capital volatility and the NII sensitivity. As a group we are very sensitive to the downside in rates, so when we're talking about hedging, we're trying to reduce the capital sensitivity without affecting the NII sensitivity, because we want to be protecting ourselves to the downside and not to the upside, of course.

So far we have reduced the sensitivity to capital on the interest rate risk by about 60% since Q1, so that makes the impact much less significant. We flagged to you that the sensitivity to another 25 basis point move would be about $500 million, which is about half what we had at the time. If you compare to the end of the quarter, rates first came off so we had a positive impact to capital, and they have come back. I would say that we're roughly where we were at the end of the quarter at this point, but of course we are subject to whatever happens from this point on.

RICHARD O'CONNOR: The UK hedging and UK sterling weakness, Carlo?

CARLO PELLERANI: Yes, so that's as part of the FX comment I made generically. In the quarter we had 10 basis points. I'm not going to comment on each currency specifically, but that's the type of magnitude that we have in sensitivity to FX.

RAUL SINHA: Maybe just to follow up on the 14%, what kind of RWA assumption? You must have some optimisation coming through in the second of the year, and related to that, you must have an assumption of credit migration as well. I'm just wondering if we can get any more sense on what you think RWAs will shape up, especially towards Q4.

EWEN STEVENSON: I'm not going to give an RWA forecast, but we've taken all of that stuff into account. As I said, we track our common equity tier 1 daily, and as of yesterday we're still in line with the guidance we gave at Q2.

PERLIE MONG, KBW: The first question I have is on prime rates in Hong Kong. You've reduced the discount on the price cap recently, so presumably that doesn't have a negative effect from the prime rate rise that you've talked about in the half year, so what stops you from doing that instead of putting prime rate up in the future? What's your thinking about it, and just the considerations around that?

Secondly, the target assumptions factor in a lot of the positives from a rate rise cycle, but not a huge amount from the downside in terms of cost and credit, etc. Given the backdrop we are in, where do you think might be more at risk in terms of the targets?

EWEN STEVENSON: Do you want to take the second one first, Carlo, and maybe Ming can talk about prime rate in Hong Kong?

CARLO PELLERANI: Can you clarify? I'm not too sure I got the detail of what you were after. Can you explain again?

PERLIE MONG: So the Hong Kong mortgage, the price cap used to be prime rate minus 2.5% but it's just been reduced to 2.25%.

EWEN STEVENSON: Maybe Ming can take that question.

MING LAU: I'll perhaps take the prime rate one first. Overall, if you look back over history, in the market in general I would expect prime rates to start moving when the base rates get closer to 300 basis points. I think the Fed base rate now is about 225 to 250. The market in general is getting close to that point. For us overall there are things we'll monitor besides the market, including competition and the overall liquidity and funding levels internally.

On the mortgage rate itself, we reduced the discount on the mortgage cap by 25 basis points, so the mortgage caps now are essentially BLR minus 225 basis points. For the back book in general I think the average pricing or the mortgage cap is about BLR minus about 250, 270 basis points.

EWEN STEVENSON: Ming, do you want to talk about what you're seeing a bit about depositor migration as well?

MING LAU: If you observe where the market levels are at, time deposit mix at this point in the market overall is probably up to about 39%. The peak in the last five years or so has probably been for the market about 50%. If you look at where the market is heading we are seeing the migration of client deposits back into time deposits. I'd expect that to continue at this point as rates continue to move higher. I think there is a risk for the market in general where the mix overall for Hong Kong might exceed 50%, but that depends on how high the base rate's end point will be at.

EWEN STEVENSON: Within that, Ming, though, we're materially lower, right?

MING LAU: Yes. At the end of December we were in the single digits, so we are starting to see that creep up in Hong Kong.

EWEN STEVENSON: I think broadly for now, given where rates have got to in Hong Kong, further rate rises will be, Ming, largely neutral to slightly negative for us.

MING LAU: We're getting to that point, particular to Hong Kong dollars, with the mortgage rate caps kicking in. Any incremental uplift in HIBOR will likely mean marginal to negative.

EWEN STEVENSON: But we'll still get the benefit, presumably, Ming, in the US dollar book.

MING LAU: Yes, the US dollar book will continue to see benefits coming through, but it's the Hong Kong dollar book where the NII sensitivity on the upside will start getting capped out. If we do raise the BLR it actually ends up being negative to us, just given the overhang of deposits priced off of the Hong Kong dollar savings rate, relative to the loan book priced off BLR.

RICHARD O'CONNOR: On Perlie's second, we've talked about upsides on NII, but you're talking about what the downside risks are in costs and impairments. Is that right? It's probably more of a Ewen question.

EWEN STEVENSON: On the downside risks on impairments, each 10 basis points of additional impairments is about $1 billion. When you look at the interest rate sensitivity we're massively geared to rising rates, even if you were to assume some tick-up in impairments. The guidance on impairments continues to be where we were again at Q2, that we think we will trend towards 30 basis points this year, and we're not seeing anything in the last few weeks that would change that view.

MANUS COSTELLO, AUTONOMOUS: Just back on capital, you're doing a Liability Management Exercise at the moment for some of your legacy debt. I just wondered if you could give us an indication of how much of a common equity tier 1 ratio impact that might have, and, assuming that's embedded within your forecast, whether there's any NII implications of it. I think there's still about $6 or 7 billion of remaining legacy debt. Should we factor in some additional capital common equity tier 1 headwinds from retiring that debt as well?

CARLO PELLERANI: Thanks, Manus. We have a significant stack of legacy securities, as you know. What we have said is that we will address those to an extent that the impact to the cost base is limited, and that's the case with this exchange. We've taken account of what is called exchange accounting, which basically means that we don't materialise any P&L on the securities you're taking out in exchange for the new one, so it's just the fee differential that hits

your capital, and it's a limited amount. Going forward it's pretty much going to be the same idea: we will look at each component of the stack and we will assess. To the extent that the cost is reasonable then we will address it, so nothing significant.

MATTHEW CLARK, MEDIOBANCA: Can I ask a question on inflation and lending volumes? Is inflation good or bad for volume growth, do you think, on net?

EWEN STEVENSON: High inflation is net-net negative for us. It's negative on the cost structure. It's negative on macro. Macro is probably the main driver of volume growth rather than the underlying inflationary impacts on volume growth, so net-net, I would say negative.

RICHARD O'CONNOR: It's positive for trade, as we've seen, albeit not just price, it's volume. We've seen very strong volume growth in trade. It's a relatively small part of the book, about 10% of the book. Elsewhere, both in retail and wholesale, people are borrowing, unless it's involuntary, which is bad. It depends on confidence: confidence to invest, confidence to buy a house, confidence to buy a car, and so to the extent inflation impacts confidence – which it's clearly doing – then we think it would be net-net a negative to our business.

Before we get too bearish - here in the UK we've seen very high inflation. We are seeing inflation higher than normal in Asia, but just to be aware, we have a different footprint. In Asia and the Middle East, there's a different dynamic. The Middle East is booming at the moment. Asia, certainly outside of Hong Kong and China, had a very strong first half. I think your general point is noted, particularly in the UK, where it is impacting confidence in both the personal and the wholesale sector.

MATTHEW CLARK: Is there an optimal level of inflation, in your perspective?

EWEN STEVENSON: Probably mid-teens is not optimal.

RICHARD O'CONNOR: We're not going to do a Brian Pitman on you. Don't worry about that. Brian Pitman talked about inflation all the time, for those of us who have got the grey hairs.

EWEN STEVENSON: In terms of global macro, I think for 2023 the UK is going to be slower, but places like Hong Kong and China are probably one of the few parts of the world we're going to see better macro growth in 2023 than in 2022. If you think about the mix of our business, while UK will be slower we do think Hong Kong will pick up as Covid restrictions progressively lift there. But again, we've guided to mid-single-digit loan growth for 2022-2023. I don't see at this point there's any reason to deviate from that guidance.

ALISTAIR RYAN, BANK OF AMERICA: Just on the dollar rate sensitivity, then, please - dollar rates have moved again since the half-year results - how sticky is the rate sensitivity to the upside? So you talked about how Hong Kong dollar fades from here, but the US dollar number feels like it should still be quite meaningful, if the forward curve comes through, which is somewhat better than it was at the time of the half-year results. Thank you.

CARLO PELLERANI: I would say similar to what you saw in the first quarter. I think that's quite indicative of what we have seen. I wouldn't expect it to be any different to what you have seen so far.

EWEN STEVENSON: I guess the only thing, Alistair, is, as rates keep going up, deposit betas are going to progressively rise as well. In the modelling we put into our results, there's a 50% pass-through assumption. It's been well below that so far, but you would expect it to progressively go up as rates continue to rise from here.

MARTIN LEITGEB, GOLDMAN SACHS: Could I just ask on the outlook for the UK? Obviously very strong print in terms of revenue and NI progression. I was just wondering, in terms of cost of living squeeze, asset quality, how worried are you in terms of your UK business from here? Any particular pockets in the loan book where you would be focusing on?

EWEN STEVENSON: Firstly, for our own staff, a couple of weeks ago we announced a £1,500 one-off payment to any of our staff who were getting paid less than about £30,000. The cost of that is about £20 million-odd, so it's not a material number and not a permanent feature of the cost base.

I do think this will be a slightly unusual recession in the UK, but if we look at what happened post-Covid, we've got mainly on the retail side an affluent customer base. We know, in terms

of the deposit flows, that customer base – savings rates went up enormously, so all of them are sitting on far higher levels of savings than they typically would at this point, heading into a recession. So we do think, in the nature of our UK retail customer base, they are likely to be substantially less impacted than, say, the bottom three or four deciles of society, who undoubtedly will have a very, very tough time, given what's happening with energy prices.

And equally on the corporate side – this is both a UK comment and a global comment – we've seen the global corporate sector being effectively deleveraging now for two and a half years. Global corporate loan growth and UK corporate loan growth have been below nominal GDP since Covid. So mainstream corporates are sitting on very healthy balance sheets at the moment.

You can look at our IFRS 9 modelling, if you want, to create adverse scenarios for the UK and what may happen with impairments, but I think similar to what you've seen with some of the other UK banks, we're not seeing anything at the moment that causes us undue concern, but the impacts on the UK economy and some parts of the UK economy are going to be severe.

RICHARD O'CONNOR: I would just highlight the Business Banking side. We showed you a massive deposit surplus in that sector. Of the lending, a large chunk is government guaranteed. That's an area that we'll see headlines over the next few months coming through, and therefore that's something I know the team's watching, but it's not a huge part of our book, but I think that's an area worth watching.

On the cards side, as Ewen said, as at early August we hadn't seen involuntary borrowing on cards, but the most recent numbers might hint at that in terms of the July and August numbers, but I think it's too early to say.

MANUS COSTELLO: Can I just follow up on that? You seem to be talking about a UK recession where you're not going to see a particularly severe increase in impairments, but you do get a windfall from higher interest rates. We've seen in some areas of Europe some governments starting to tax those windfall profits. Obviously, we've got a change of regime coming in the UK with lots of unfunded policies. How concerned would you be that there could be measures taken in the UK politically to try and capture some of those windfall profits and how might that play out with your shareholders?

EWEN STEVENSON: Well, we already have an excess tax called the bank levy that we've had for the last decade, so we think we are already, as an industry, subject to a windfall tax. As a reminder, we didn't fail in the banking crisis so we've been effectively paying a windfall tax for over a decade, but there's no signs that the Conservative government is thinking about this. And the normalisation of interest rates is hardly windfall profits.

RICHARD O'CONNOR: We've got a corporate tax surcharge as well as the bank levy. We've actually got two taxes already applying to us in the UK.

BENJAMIN TOMS, RBC: On costs, as rates go up and revenues go up, do you feel any more freedom to loosen the purse strings on costs? And are there any areas of investment that you've been waiting to make which next year you'll be able to execute now that you've got a higher revenue base?

EWEN STEVENSON: Actually one of the reasons for being very clear externally on costs – flat this year and 2% next year – is as much an internal message as it is an external message. We don't want to go back to what, when I joined at the back end of 2018 – we had 5.5% cost growth in 2018 because we did exactly what you said, which is we planned to spend the benefit of rate rises. So we're firmly not trying to do that. That does mean, with underlying wage growth across the organisation, we'll be higher than 2% next year inevitably, which means we are having to drive through significant productivity improvements, and if you asked the organisation how much would they like to spend on investment, it adds up to far more than what we're spending, but that's just part of a normal budget and constraint process.

And bluntly, I don't think we're getting paid for growth at the moment from the equity markets, so if there's a trade-off between cost control and growth, I think we're getting paid for cost control; we're not getting paid for growth.

RAUL SINHA: Can I follow up on that? There's quite a big chunk of the CTA budget still left for this year. Where is that going to go and how can you de-risk some of the cost inflation next

year by targeting savings this year? Are you doing anything different to counteract that wage inflation?

EWEN STEVENSON: A big chunk of that cost-to-achieve budget is going to generate additional cost savings which will flow into next year. We've said in the original programme of $5 to 5.5 billion – we expect to be at the top end of that by the end of this year, and we expect on top of that to now achieve about $1 billion of additional savings going into next year, which is 3% of our cost base.

RAUL SINHA: Where is that going?

EWEN STEVENSON: Across the board. If you look at broadly what we're doing, you can see headcount continuing to come down. We've committed to get out of a significant amount of our corporate real estate book. A large part of that is driven by hybrid working. So we've committed to get out of 40% of our commercial real estate globally over about three or four years. I think by the back end of the next year we'll be broadly there on that, and then a lot of work is going on in the IT space to refine and rationalise legacy IT infrastructure, legacy applications. I would say in the US the restructuring there will be largely completed at the end of this year, but there's still a lot of infrastructure that's going on in Europe, which will continue into next year as well.

So I would say US will be done by the end of this year. Europe will be largely done by the end of next year, but there's no single big programme of work. Every part of the bank has got various cost initiatives underway.

RICHARD O'CONNOR: And back and middle offices in wholesale, in trade as well. So it's generally across the board. We can't say there's two things which are 50% of it. It's a very balanced programme.

EWEN STEVENSON: We've just, for example, recently been through our entire chief operating officer cadre and have taken out about 40% or 50% of the chief operating officers in the bank, and that's as much and more driven by a desire to drive simplicity and efficiency rather than with the significant cost benefit that comes on the back of it.

JOSEPH DICKERSON, JEFFERIES: How do you see the, for lack of a better word, dialogue with Ping An evolving over time? So you put up your slide – I think it's 26. They've come up with a rebuttal to that, although omit any comment about US dollar clearing and so forth. Is this just going to be, over the coming quarter, a similar type of movie or how do you see from your side the discussions advancing? It obviously creates a lot of noise in the marketplace. You're talking about investors not paying for growth, but there are concerns in some parts of the market about sloppy breakup risk and that kind of thing, as remote as it may seem. So what's the endgame, if you will, on the dialogue with Ping An?

EWEN STEVENSON: They're our largest shareholder. As you'd expect, we are in regular dialogue with them. As we said as part of the second quarter results, while the work is not finished, all of the work that we've done to date would say it's very costly to put in place any structure that's being proposed. There's a three to five-year gestation period to do it, whether that be creating the MREL stack required, creating the IT stack required, getting the regulatory approvals required. So costly and lengthy to put the structure in place, and then material dis-synergies once you've put the structure in place, so, yeah, we are struggling to see that there's a value case here that would possibly make sense to put in front of our shareholders.

So, our plan is to execute our plan. We think if we execute our plan, that drives material returns, profit, distribution upside. As we said, we expect to get back to a 12% return on tangible equity next year, and we've said we're committed to paying half of that out by way of a dividend. That gets you to materially higher distributions. I think if we achieve a 12% return next year that we fully expect to do, we think the share price is materially undervalued relative to that performance.

So what's the endgame for Ping An? I think a much higher share price, probably, hopefully, is an acceptable compromise for them. We think their in-price is probably around HKD60 a share, so we're about HKD50. So we think there is a path to getting our share price to a level that's comfortably above their in-price, which allows them to then take a different stance in relation to their current position. But in terms of the structural options, I think we have a not yet complete but pretty clear view that what is being proposed is value destructive.

RICHARD O'CONNOR: And you saw their results. Their investment yield is about 5%, and our dividend signalling, if we achieve our plan – you can do the maths and work out that they've got a higher than that, up to end of 2019, dividend yield. And you know what the plan is over the next few years, and that's been a big component of the unhappiness.

PERLIE MONG: Can I just quickly follow up on the question that we just discussed? So I guess there's also a feeling that Ping An, as well as maybe Hong Kong retail shareholders, are unhappy about – it's not just the financials. They're just unhappy that the key asset in Hong Kong is being governed and managed in the UK, in which case it's slightly synonymous with the geographical challenge that HSBC might face as a firm straddling between the east and the west. So, with that in mind, is there something that you could do to meet in the middle? I know that in the past years you've explored options like moving the headquarters to Hong Kong, which was not taken up. So what else can you do to meet them in the middle in terms of the more politically driven concerns?

EWEN STEVENSON: I think the answer is a much higher share price and much higher dividends. Then I think Hong Kong retail is very happy. What they have been unhappy with was the fact that the dividend got blocked a couple of years ago and the share price went down. But we don't sense that there is a groundswell of Hong Kong retail who wants anything other than a higher share price and better dividends.

RICHARD O'CONNOR: We had an informal shareholder meeting in Hong Kong a few weeks ago. We had 1,000 retail investors there, and there were more on their way. Unfortunately, we had to cap it at 1,000. So there's still a lot of interest, a lot of support. And questions were – at least the feedback in the room was dividend-related. There was a campaign group who were very unhappy and indeed complained about a dividend cancellation a few years ago. So they did ask a few questions, but the groundswell in the room was very much about the dividend and the success of the Group, I would say, and it was actually a very, very civil and constructive meeting, in our view.

EWEN STEVENSON: But even just a simple moving the headquarters from here to Hong Kong is something that we looked at extensively in 2015 and 2016. We've refreshed all of that work. You still come for the same conclusion that it is very valued destructive. It would require 75% shareholder approval, and we just don't see how we could put a value-destructive proposition to shareholders and expect to get 75% approval for something like that. We've seen numerous proposed corporate restructurings that just haven't happened because there's no value case for them.

GURPREET SINGH SAHI, GOLDMAN SACHS: Back to Hong Kong with the question, we've seen HIBOR move up a lot. Even with the reasonably moderate move in the second quarter, we managed to get a good pick-up in the HBAP margin. So can I ask – quarter to date, one-month HIBOR, as a reference, is up 100 bps Q on Q, and in September it might move up more. So what kind of margins are we expecting for the HBAP or the Hong Kong business going into the third quarter? And I understand, after that, as Ewen mentioned, there might be some sort of moderation in the margin pickup, but why I ask is that back-of-the-envelope calculations seem to suggest that maybe the Hong Kong margins might be up like 30 or 40 basis points in the quarter?

EWEN STEVENSON: Ming, maybe you can answer that without giving a NIM forecast.

MING LAU: I won't give a specific NIM forecast, but second quarter margin for HBAP was 146 basis points. The bulk of the rise in HIBOR has come through, I would say, in the past couple of months. So I think it's fair to say the uplift from Hong Kong to all the rate movements in HIBOR has not been fully reflected in the second quarter result. So I think, Gurpreet you would be safe to assume the third quarter margin for HBAP would be a good amount higher than the second quarter, but I'm not going to give you a specific number on that.

Just looking at our July and August performance, we are seeing an uptick in Hong Kong at a faster rate than we saw through the second quarter on margins and NII.

IAN GORDON, INVESTEC: Could I go back on the windfall options? I hear you that conservative governments don't do windfall taxes but we don't have a conservative government. I want to ask about your views on simplicity of options. Now, clearly, in the unlikely event that the Tories cut corporation tax, it's quite easy to reverse a bank levy. What about the options of reducing the remuneration for banks for deposits with central banks? Do you see that as a straightforward exercise and what unintended consequences are there?

EWEN STEVENSON: I can see significant unintended consequences if that were to happen.

IAN GORDON: Would you care to elaborate?

RICHARD O'CONNOR: Carlo, any comments?

CARLO PELLERANI: Not really.

RICHARD O'CONNOR: For the record, Margaret Thatcher did do a windfall profits tax in 1981, so there was a windfall profits tax.

EDWARD FIRTH, KBW: Apologies for the slightly detailed question, but I was just messing around with some numbers and I noticed that really over the last couple of years, you've been capitalising software, internally generated software, at about $1 billion a year higher than you're amortising it, which is quite a big shift, even in the context of the size of HSBC, that's quite a big effective cost gap. So I'm just wondering, how would you expect that to develop over time, looking out not over the next year but over the next two, three, four years? Should we be expecting that amortisation to rise towards the level at which you're capitalising it or is there something extraordinary about the level you're capitalising at the moment? Thanks.

JONATHAN BINGHAM: There's no change in policy or approach in terms of how we capitalise. We took an impairment a couple of years ago. Broadly, what you're seeing there is digital investment coming through and, as we invest in digital, that pushes up the amount of software that we've got in there. That will naturally – because we've been on that journey, investing in digital – start to level out, so it will start to normalise, but we've not given any guidance to that.

RICHARD O'CONNOR: But it's in line. You saw the growth in the technology budget as a percentage of the cost base. It's in line with that trend as well, and clearly there's an element of CTA, which would support Jon's view that it will start to level off over the next couple of years, once CTA comes off as well.

EDWARD FIRTH: By the sound of it, then, it's nothing extraordinary, so over time, assuming your software is not going to last forever, those two numbers should converge. Is that right? So $1 billion a year of amortisation should steadily creep up to the $2 billion a year you're spending?

JONATHAN BINGHAM: Over time they will. We're still seeking to increase some of our digital investments, so it is a few years away.

EWEN STEVENSON: But Ed, overall, yes, amortisation costs will go up. That is factored into all the cost guidance that we've given. It will take several years, I think, to get to that normalisation that you talk about.

EDWARD FIRTH: The alternative is you could periodically just write it off, but I guess that's a slightly questionable way of approaching it, but I know a number of other banks do it that way.

EWEN STEVENSON: As you say, it is slightly questionable.

MANUS COSTELLO: Just a point of clarification – on your slide rebutting the breakup argument, you talk about a loss of deposit funding across Asia network countries as one of your – from branches. I wonder if you could elaborate on what you're referring to there and why you think that might be a problem in the –

EWEN STEVENSON: If we break the synergies between east and west, there are significant cash balances that are held across Asia on behalf of western corporates and if, effectively, we lose a meaningful part of those western corporates' eastern business, then one of the side effects of that will be the GLCM balances that sit across Asia with us.

RICHARD O'CONNOR: To think about it another way, as you've seen with the ring-fenced bank in the UK, if you ring-fence something, then you get deposits in that ring-fence which, currently, under the Asia scenario, fund wholesale funding in the network countries around Asia.

MANUS COSTELLO: I think what you're talking about, Ewen, is multinationals which might choose to deposit elsewhere.

EWEN STEVENSON: Well, there's two things, right? Ping An has also suggested, which Richard is referring to, a structure where we would ring-fence Hong Kong and China retail. In that scenario, that would be even more severe, because effectively you would be breaking the nexus between the wholesale-funded Asian book which is currently funded materially out of the retail deposit surplus in Asia, in Hong Kong. But even without that, if you were to just separate Asia, what we would expect to see is a significant loss in GLCM balances from western European corporates.

MANUS COSTELLO: Apologies, I can't remember if you put it in the slides, but have you given a number for corporate deposits that would be –

EWEN STEVENSON: No, we haven't.

RICHARD O'CONNOR: But you could look at the disclosure and you could take your own view, Manus, quite easily. If you look at disclosure within the Asia retail wholesale books, you could take a view on it.

MIRUNA CHIREA, BARCLAYS: I just had a quick question on the UK mortgage market. What we've seen in the last few weeks has been a rapid increase in the swap rates. I think two and five-year average swap rates are up around 100 basis points in the last month or so, so I was wondering how you're thinking about HSBC's ability to increase pricing to keep in line with the swap rates from here and how this translates to mortgage spreads?

RICHARD O'CONNOR: Many of you will have seen that we've put both some – I stress 'some' – of our deposit rates up and our mortgage rates up over the last few weeks, so, as you saw in Q2, rates are moving up quite fast and that remains the case. So we're taking action on both sides of the book to make sure that our pricing is appropriate and is return-enhancing.

It's probably fair to say that, a couple of months ago, we were a little bit behind the curve when you look at the returns on the mortgage business we were writing and we're trying to get to at or above that curve, and that's what you've seen in our pricing in the last couple of months. We're still very happy doing business in the UK mortgage market. It's a profitable business. We're expanding in it, but clearly we need to do it with the right level of return and that's what you've seen with our pricing in the last couple of months.

GUY STEBBINGS: You talked about the significance of dividends for some of your investors, specifically in Hong Kong, and I think it's probably consistency of dividends as much as it is the quantum of dividends and how that plays through with the dividend cut that came through.

There was a recent Bank of England speech, talking about potential changes to the capital framework in the long, long term, perhaps, and how this crisis and other crises have shown banks' unwillingness to go into capital buffers, even though the idea is they're supposed to be there to be used into a downturn to support the needs of the economy. And there was a suggestion that, to reduce stigma for certain banks to go into the buffers, that you just have a blanket ban on dividends for everyone, no matter what their capital ratio is.

And maybe we can say that's just unlikely to happen, but were the Bank of England to go down some sort of route like that – or wider regulators in Europe, perhaps – how would you view such an action, both personally as a bank and also for your investor base?

EWEN STEVENSON: We viewed the action that was taken in early 2020…we understood it in the context of … a very early stage of Covid and the extreme uncertainty that existed, and it wasn't just the UK regulator that did it. A number of regulators did it globally. What we particularly objected to was the fact that we were two weeks after going ex-dividend and I think, if you think about what you're trying to achieve is extreme downside protection, cutting a dividend is not going to solve that.

Our main recovery action in an extreme downside scenario, as you saw in the global financial crisis, was all the banks going out and raising equity, and we think that blocking what was a $4 billion dividend payment had a significant impact. If we had been forced to go out and then raise equity, the net amount of capital we would have been able to raise would have been considerably less as a result of that saving of $4 billion of dividends.

So I understand what the Bank of England have said and mused on. We've consistently said to them that there are reasons people don't cut into buffers. It's got nothing to do with their

buffers; it's got to do with the market signals and how the market interprets it, and that stigma is not going away. So I think if they were to codify this musing, that they might have a persistent approach at blocking dividends, I think that would be very negative for the banking sector.

RICHARD O'CONNOR: It was one policymaker and I think they are taking the view that, actually, you would have to – best done on a global basis. When the Bank did it, I think they thought that other jurisdictions would follow and they didn't, so that's part of the reason behind the speech, but there's no signs that jurisdictions in other parts of the west, or indeed the east, have any view like that.

Thanks very much, everyone. Thanks very much for the interest and the very strong attendance and we're around in the next few weeks, Tim, Mark and I, to have conversations, but in the meantime I hope we all have a productive September.

EWEN STEVENSON: Just to conclude from me, I think as you've heard, there's no change to the guidance that we provided to you a few weeks ago, despite several things going on in the markets in between time, so thanks.

RICHARD O'CONNOR: Thanks, everyone.