Transcript

Fixed Income Results 2017

Conference Call with Analysts and Investors hosted by Iain Mackay, Group Finance Director

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Corporate participants:
Iain Mackay, Group Finance Director
Iain MacKinnon, Group Treasurer
Richard O'Connor, Head of Global Investor Relations
Greg Case, Head of Fixed Income Investor Relations

HSBC

Iain Mackay, Group Finance Director

Thank you. Good afternoon, and welcome to our inaugural Fixed Income Results Call. With me today are a number of colleagues from our Treasury and Investor Relations Team, including Iain MacKinnon, our Group Treasurer. I expect most of you have had the chance to listen to Tuesday's call, where we ran through the results in detail. I'll run over a few key points briefly, and then we'll open the call up to Q&A.

2017 was a good year for HSBC. Reported profit before tax of $17.2 billion was $10.1 billion higher than 2016, due mainly to the non-recurrence of a number of large, significant items. Adjusted profit before tax of $21 billion was up $2.1 billion, or 11%, with increases in all four of our global businesses and four out of our five regions. A strong revenue performance helped us achieve positive adjusted jaws of 1% in 2017, more than covering increased business investment and higher performance-related costs.

Retail Banking and Wealth Management had an excellent year. Strong deposit growth started to benefit the bottom line as interest rates began to rise. We also continued to grow lending in our target markets, especially Hong Kong and the United Kingdom. Commercial Banking adjusted revenue grew well, on the back of an outstanding performance in Global Liquidity and Cash Management. Global Trade and Receivables Finance revenue stabilised after a difficult 2016, and we increased our market share in key geographies. Global Banking and Markets grew adjusted revenue for the year, due mainly to the strength of our transaction banking businesses. Growth in the first three quarters of the year in Markets and Banking enabled both to withstand the effects of subdued market activity in the fourth quarter.

Global Private Banking adjusted revenue continued to reflect the impact of historical repositioning, but was broadly stable over the course of 2017, and grew by 10% in our target markets. Adjusted loan impairment charges were significantly lower than 2016, with our loan impairment charge reflecting 19 basis points of gross loans. This is primarily related to improved conditions in the oil and gas industry in North America. Our strong Common Equity Tier 1 ratio of 14.5%, included the effect of recent changes in US tax legislation, which reduced our capital position by nine basis points. It was also net of buy-backs throughout the year, which totalled $3 billion in 2017.

Implementation of IFRS 9, including benefits from classification and measurement changes, will result in a favourable impact on our Common Equity Tier 1 ratio, applying the European Union's capital transitional arrangements. The fully loaded day 1 impact is expected to be negligible. Liquidity and funding remains strong, with $600 million of unencumbered liquid assets on hand. Our liquidity coverage ratio stands at 142%, while loans and advances are equal to just 71% of our deposit base. We're well on track to meet our end point MREL and total capital requirements ahead of time. In 2017, we issued $12 billion of MREL-eligible senior bonds, bringing the total outstanding to $43 billion. We reiterate our issuance plan guidance of between $60 and $80 billion, albeit some uncertainty remains over where our final MREL requirements will land.

Alongside MREL, we plan to issue $5 to $7 billion of Additional Tier 1 bonds in 2018, compared to our 2017 issuance of $5 billion. While we expect to complete the issuance in the first half of 2018, this will depend on a multitude of factors, including market conditions, and we seek issuance windows that allow issuance at the lowest possible costs. In Tier 2, we have no plans to issue this year, given our healthy excess in this area. We may also look to issue a small amount of senior preferred debt from a number of our operating subsidiaries to fund growth, albeit benchmark transactions would be limited.

To conclude, HSBC has a strong credit story. We've a robust capital ratio and strong revenue generation. Our diversified balance sheet and international network is balanced by both product and geography, while leaving us better able to connect customers to opportunities in the world's fastest-growing regions. With that, we're now happy to take your questions. Thank you very much.

Paul Fenner-Leitao, Société Générale

I've got four very, very quick questions. First, on issuance plans, obviously, Iain, there's been quite a move since the meeting that you held at your offices whenever it was in August, so on a scale of one to 10, how comfortable do you now feel that the guidance stands, and how likely is it to potentially change or even increase substantially from here? That's point number one. Number two – obviously, new management. You keep talking about the pivot to Asia. Has the move to Asia headquarters completely gone away as an issue, or could that potentially come back? Third, the supply out of the OpCos – is that purely an arbitrage play, or is there something going on in terms of arbitrage, in terms of the cost of funding? Was there some regulatory reason to do that? And then the fourth is, can someone explain what the technical issue is behind the inability to issue AT1s while simultaneously doing buy-backs? I just want to understand that. Thank you.

Iain Mackay

Okay, Paul. Quite a lot there. I'll take the last one: there is listing authority guidance, both in the United Kingdom and Hong Kong, which prohibits one's ability to do capital security issuance whilst at the same time doing buy-back of capital securities, and clearly consideration of AT1 issuance is a capital instrument and clearly our ordinary share is a capital instrument. So, it is a listing authority regulation. It is not, as far as I'm aware, something that is promulgated by our prudential regulator. It is very much aligned to listing authority requirements. That is the technical – and this is something we ran into the first time we did a buy-back in 2016, as we just went through the various – because it's the first time we'd ever done one, we went through a review of all regulations that may impact any buy-backs, and this was one of those that we came across at that time. Going to your first question –

Paul Fenner-Leitao

You'd also be disallowed from doing a write-down AT1?

Iain Mackay

I think any action – well, any capital instrument issuance would be limited if one were in a buy-back period.

Richard O'Connor

We take a very prudent view of the rules here, and obviously don't want to confuse the markets.

Iain Mackay

Going back to your first question, you're seeking guidance on what – the regulatory outlook? The outlook for –

Paul Fenner-Leitao

Yes, I suppose the supply outlook is a derivative of the regulatory outlook.

Iain Mackay

Well, look, clearly guidance received from the Basel Committee on Banking Supervision in early December of last year was a step in the right direction. It was helpful. However, there are, within that guidance, over 60 areas of national discretion which may be applied, and as the name obviously connotes, national discretion means that different national regulators can interpret how they may wish to apply those components of regulation differently. There are areas within that guidance, particularly as it relates to operational risk and the regulatory treatment of CBA, which are perhaps – have greater influence in terms of how we may be able to evaluate any RWA inflation that emanates from the guidance that was issued in December by the Basel Committee. So, though clearly a step in the right direction, there is still a broad range of possible outcomes subject to that national discretion.

Now, as far as we – where we stand right now is that our principal regulators – our principal regulator, the PRA, and then others, to consider the HKMA, the Federal Reserve, the Monetary Authority of Singapore, for example; the ECB, obviously – are very much still in the mode of evaluating that guidance and how they may choose to interpret and apply across different dimensions of national discretion. So, at this point, in terms of providing meaningful guidance around what the December publication represents in terms of RWA inflation for an organisation that operates across 67 different jurisdictions with almost 40 regulators guiding prudential requirements in those jurisdictions, it is quite difficult at this point in time to do it. But we are looking forward to engagement with our principal regulators to try and obtain insight. We will, I'm sure, in the fullness of time obtain insights as to what that may mean. So, I think in the round, Paul, what this means that although we've taken a step forward, there are still a number of significant areas of uncertainty with respect to how exactly Basel IV will be applied to the industry.

Richard O'Connor

But, Paul, are you asking about our AT1 and MREL plans for this year?

Paul Fenner-Leitao

I was talking about MREL guidance, the 60 to 80, which was at the lower end, and now it's changed, and obviously quite a bit of AT1 coming and all front-loaded. So all of that is quite a departure from the guidance that we started being given in the second half of last year and into the beginning of this year, so I just wanted to understand – look, I don't blame you for the uncertainty. I just want to get a sense of how confident you feel about the outlook for this year and next.

Iain Mackay

Okay. So, 60 to 80 is still the guidance. Where we fall in that range will be to no small degree informed by where the application of the Basel requirements are informed, as we've just discussed, and from an AT1 perspective, you've got five to seven this year, clearly targeting the lower end of that range. If there is good pricing and good demand, then we may well consider up-sizing the transaction, and from a MREL perspective, broadly speaking in the range of 12 to – it's about 15 to 17 billion this year, a little bit more than last year. But, again, where we are right now, we've got about 43 billion of MREL outstanding. The range of 60 to 80 remains certainly the guidance for the market at this point in time, and our goal is to be clearly compliant with where we need to be on 1 January 2019, but also with an eye to where we need to be on 1 January 2022, recognising there's some uncertainty about what exactly that is. So, I think the best way to leave this at the moment is five to seven on AT1; 12 to 17 on MREL within the context of 2018.

Richard O'Connor

And, Paul, just to say, clearly, you'd expect us to get to our target ranges with a small buffer in good time, and this plan reflects that. We said last year we weren't in any rush. That remains the case, but you'd expect us, where market conditions are good, to obviously issue to get towards our end state plans.

Iain Mackay

You had two other points, Paul. Have we addressed them?

Paul Fenner-Leitao

It was Asia and the OpCo issuance.

Iain Mackay

No, I don't think we'll be – I mean, John has just taken over, but I do not believe the location of the headquarters will be anywhere near his list of priorities for the foreseeable future, if ever. And as far as OpCo guidance goes, it is really about funding local growth plans and being opportunistic in the market, as opposed to anything other that you could read into this.

Richard O'Connor

And that hasn't changed, Paul. Last year, we issued locally in Australia and Canada, for example. That's not changed through our guidance.

Iain Mackay

It's very much about local funding requirements, as opposed to anything informed by the regulatory requirement.

Paul Fenner-Leitao

And not out of the UK non-ring-fenced, for example.

Iain Mackay

So, that – the non-ring-fenced bank is HSBC Bank plc, and we clearly have issued from that from time to time, usually senior instruments to meet local funding requirements, and that may continue to be a possibility.

Paul Fenner-Leitao

Okay, very clear. Thank you so much.

Iain Mackay

Okay. Thanks, Paul. Next question?

Lee Street, Citigroup

Hello. Thanks for taking my questions. I've got two, both related to MREL issuance, but firstly: will the BEAT tax requirements in the US impact you at all, and could it potentially force you to issue out of your US entity? And secondly, a bit more broadly, should we expect any MREL issuance out of any other entities that are not the HSBC Holdings plc entity? Those are my questions. Thank you.

Iain Mackay

Okay, thanks. So, on US tax reform, I don't think it forces us to issue out of a US entity. I think the key – I mean, you clearly saw our disclosures with respect to the impact of the deferred tax asset and how that flowed through to capital. The area where I think a number of US taxpayers that operate internationally are presently examining and waiting for greater guidance from the Internal Revenue Service is the Base Erosion and Alternative Tax with respect to tax avoidance perspective. That is, as is ever the case with US tax, a somewhat complicated construct, so we are very much working through what that may mean for the Group overall, but I think our strong preference is to maintain issuance of capital securities from the holding company – so HSBC Holdings plc.

That is our first and preferred starting point as a multiple point of entry resolution entity – or resolution group, rather – but as regulation with respect to the implementation of the BEAT elements of the new US tax legislation becomes clearer, we will be able to firm up our views in that regard. But our preference, and certainly our expectation at the moment, is that we'll continue to issue from the holding company and then downstream to the main resolution hubs across the Group, as has been our practice over the last couple of years. I think – sorry, your second question was –?

Lee Street

Just MREL issuance more broadly. Should we expect it to come out of any other entities, apart from – in addition to HSBC Holdings plc?

Iain Mackay

Yeah, same answer. The preference is from the holding company and then to downstream. Clearly, at this point in time, there are really only two jurisdictions that have provided clear guidance on TLAC/MREL requirements, and that is the UK and the US. There is a consultation document out in Hong Kong with respect to their requirements locally, so as we have the main resolution hubs and then entities below those hubs providing their guidance on MREL, it will give us a) guidance as to exactly how much we need, where it needs to be pre-positioned. But, as I mentioned earlier, our strong preference is to issue from the holding company, and then downstream to the resolution entities.

Lee Street

Okay, understood. Thank you very much.

Iain Mackay

Thank you. Next question.

Corinne Cunningham, Autonomous

Hi, there. Thank you very much. A couple of questions, the first one slightly following up on Paul's. Why are you opting to front-load the AT1 supply now, where I understand it is – you have actually got a fair bit of time to get there? Is it literally just opportunistic, or is it more to give you some flexibility on the share buy-back side, because of what you were saying about the listing authority guidance? And is there a possibility that you could do some exchanges as part of that issuance plan, or is it really just opportunistic transactions as and when? And then, second question: what do you see – or how do you see the role of the discount perps, if any, once we get to the end of the grandfathering period in 2021? Thank you.

Iain Mackay

So, I think the answer to this is – to both your questions is somewhat combined, to be honest. So, there is an opportunistic element to this. As you will have seen, we had good terms against the offerings that we made, both from an AT1 and from an MREL perspective, last year, and we believe that the market continues to be reasonably attractive. And we have historically – and will continue to look for those windows of opportunity to issue capital instruments of whichever variety may be needed when we think the conditions, both from a price and from a volume perspective, are most attractive to us, so there is an opportunistic element associated with this.

We clearly want to meet our regulatory requirements with sufficient time, and as Richard mentioned earlier, a little bit of management buffer. And that's frankly to allow for the fact that there are really no allowances within the current capital management framework from a regulatory perspective to deal with volatility in your RWAs, either emanating from stress or for growth within the business. So, for that reason, we would expect to carry a small management buffer, both at Common Equity Tier 1 and Tier 2.

In terms of the grandfathering and the regulatory capital value of certain securities being discounted progressively, then again, we are looking in the round at the capital value and the cost of the overall capital structure, and making decisions based on, one, optimising the regulatory capital value and two, the cost of having these instruments in the marketplace. So, where there's opportunity for us to realise some economies from a cost perspective, then I think it is reasonable to assume that we will take those opportunities in a reasonably timely manner.

Greg Case

Just specifically on the discount perps, we would say that they are dollar perpetual liabilities at a pretty reasonable cost for us in entities that need dollar funding. So, you know, those are liabilities that we quite like at this point in time.

Corinne Cunningham

Okay, that's clear. Thank you very much.

Iain Mackay

Okay, thank you. Next question.

Robert Smalley, UBS

A couple of questions – follow-ups more than anything – on the AT1s, could you talk about currency mix and what your preference is; how that's going to map to underlying assets? Secondly, you have a few US dollar-denominated preferred outstanding, with 8%-plus coupons. Some of them, or all of them, may be swapped. Could you talk about the efficiency of that, the capital structure, and any of the obstacles that you might have in terms of calling them, as they're currently call-able and pretty high-coupon? In terms of your MREL issuance, again, currency mix, and then finally, you have been – and will be – a frequent issuer. Are you starting to run up into counterparty risk limits or any other kind of counterparty issues, given the amount of issuance that you need to do? Thanks.

Iain Mackay

Thanks, Robert. So, on the last question, no. We continue, frankly, to be probably one of the lower-volume issuers in the marketplace. So, clearly by historical standards, we've been doing more in the last couple of years than has previously been the case, but, no, we do not have any issues facing us with respect to counterparty limits or pressures in that regard.

The response to your US preferred is the same as the response to Corinne's question, which is we're looking at the overall cost, capital value, of the securities that we've got, and look to optimise the balance sheet. So, from time to time, we will absolutely give due consideration to those elements – so, the overall economics associated with the capital structure that we've got within the Group. In terms of currency mix – and this would be consistent with AT1s and MREL – we'll consider dollar, euro, sterling being probably the most prominent in the currency mix, with dollar probably being the most prominent amongst those, given the composition of our balance sheet as a whole. You'll have noticed last year that we have, again somewhat opportunistically – and following on, frankly, from demand – done some things in Japanese yen that were extremely well-received, but broadly speaking, US dollar, euro and sterling.

Robert Smalley

I didn't hear the kind of follow-up that Corinne heard about the discounts when talking about the preferred. Can we just talk a little bit about that, in terms of some of the economics of calling them with respect to swaps and the high coupon?

Greg Case

We're not going to get into security by security, and as you know, we don't really talk about hedging on an instrument by instrument basis. The economics really is, for us, as you'd expect. It's coupon cost; it's usefulness; and to be quite frank, you know, what we've got in the pipe to do. So, we'll think about all those things as it goes.

Robert Smalley

Great, and again, thank you for doing the call. Greatly appreciate it.

Iain Mackay

You're welcome. Thanks, Robert. Next question. Okay, so last chance for questions. Okay, well, thank you very much for joining today. We will continue to do these calls when appropriate, but thank you very much for joining. Bye, now.

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