HSBC

Transcript

Fixed Income Call
Annual Results FY24

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FAISAL YOUSAF, GROUP TREASURER: Hello, everyone, and thank you for joining our fixed income investor call. I'm Fas Yousaf, Group Treasurer, and I'm joined by Greg Case, Head of Debt Investor Relations, and Mark Phin, Head of Equity Investor Relations. I'll keep my opening remarks brief as I'm sure you've had a chance to go through the results already today. As usual, there's a comprehensive deck for fixed income investors available on our website. I willl show a few selected slides as I talk. Once I've finished, we'll go straight to Q&A.

So, we're pleased with our strong 2024 results, which sets us up well for 2025 as we celebrate our 160th year. We've delivered record profit before tax of 32.3 billion or 34.1 billion excluding notable items. The return on tangible equity was 14.6%, or 16% excluding notable items, in line with our mid-teens RoTE guidance. We announced a total of 26.9 billion of distribution to our shareholders in respect of '24, while retaining a CET1 ratio above our target operating range.

In the fourth quarter, we announced actions to simplify HSBC. In pairing our two home markets, the UK and Hong Kong, we've enhanced the focus on our wealth proposition via the creation of international Wealth and Premier Banking, IWPB for short, and combined our two wholesale businesses, Commercial Banking and Global Banking and Markets, into one Corporate and Institutional Banking division, CIB.

Furthermore, today we've announced a commitment to deliver cost efficiency savings of $1.5 billion over the next two years that will have no meaningful impact on revenue. We are also aiming to reallocate around $1.5 billion of additional costs, from the non-strategic activities to priority growth areas over the medium term. As an outcome of these actions, we have confidence that we will generate a mid-teens return on tangible equity in 2025, '26 and '27.

HSBC continues to be strongly capital generative, with profits delivering 340 basis points of CET1 in '24, which have largely been used to fund both dividends and buybacks to support our equity investment case. Our CET1 ratio of 14.9% remains above our target operating range of 14% to 14.5%, and you should expect us to bring it down back to this level over time.

At the mid-point of our target operating range, we will have over 300 basis points of headroom above our MDA hurdle requirement. We have built up our structural hedge by more than $200 billion since June '22, which has contributed to our sensitivity to our 100 basis point fall in interest rate, dropping by more than half. During '24, we also increased a duration of the hedge from 2.8 to 3.1 years, and we will reinvest around 95 billion of assets in each of '25 and '26, which currently have a yield of around 2.8%.

Excluding the impacts of the sales of our businesses in Canada and Argentina, the Banking NII quarterly run rate has been fairly stable through 2024, and we expect Banking NII of around 42 billion in 2025. This is based on the current market interest rate outlook, and our own growth projections.

Now turning to credit quality, the ECL charge for the year was $3.4 billion, or 36 basis points as a cost of risk, which is in the middle of our 30 to 40 basis point guidance. The fourth quarter charge was 1.4 billion or 57 basis points, which included 0.3 billion related to two clients – one in the UK and one in the mainland China commercial real estate sector. We expect our 2025 charge to be within our medium-term planning range of 30 to 40 basis points.

Stage three balances were 2.4% of customer loans, broadly stable in the fourth quarter, but up from 2% at the end of '23. The increase during the year was driven by our Hong Kong

commercial real estate book, which had a limited impact on the ECL charge due to the high levels of collateralisation of this lending.

Next, moving onto the balance sheet and issuance. As I noted earlier, our CET1 position is a strong point at 14.9%. Our MREL ratio was 32.1%, broadly flat on the year-end, 4.8 percentage points above our requirement. This morning, alongside results, we published an additional announcement affecting some of our legacy Tier 2 debt, and one of our older senior holdco notes. In order to ensure we avoid infecting our remaining Tier 2 securities at the end of the CRR grandfathering period in June, we have proactively chosen to stop recognising $4.3 billion of legacy Tier 2 securities as both Tier 2 and MREL. In addition, for consistency, we've also chosen to stop recognising a $750 million senior holdco note as MREL. Both of these actions are effective immediately and will reduce our MREL ratio by 54 basis points.

Moving onto liquidity, the Group retains a large and well-diversified deposit base, with strong levels of liquidity. We have a total deposit base of $1.7 trillion, and our loan-to-deposit ratio is 56%. Across our two home markets, our deposit base continues to skew significantly more toward current and savings accounts than we see across the broader market. We hold $0.8 trillion in high-quality liquid assets, and the Group LCR was 138%. As you will have heard me say before, the group consolidated LCR is calculated using conservative assumptions. We primarily manage liquidity at the subsidiary level, and our major subsidiaries all operate with LCRs that are significantly higher than the Group ratio.

Finally, onto issuance. Last year we continued to focus on diversifying our currency mix and proactively managing our maturity profile via liability management. Two-thirds of our holdco senior issuance was in US dollars, and we are particularly pleased with the reception we received in Singapore dollar and Australian dollar. We expect our issuance plan in '25 will be similar to last year, and net issuance needs will be modest. We will continue to look for opportunities to diversify our issuance, utilising our broad name recognition, particularly across Asia.

Starting with holdco senior, we expect to issue around 16-18 billion, against maturities and calls of around 14 billion. In Tier 2, we expect $2-3 billion, against just under 3 billion of maturities. In AT1, we are planning for around $3-4 billion. We have recently announced the call of our only AT1 due this year, which will remove $2.5 billion in March.

So, wrapping up before handing off to Q&A, another strong year which, combined with our increased focus on simplification and efficiency, sets us up to continue to deliver strong returns as we look out. We maintain prudent capital, liquidity and funding positions, and we have modest net issuance needs in '25.

On that note, let's open the call up for the Q&A, Greg?

GREG CASE, HEAD OF DEBT INVESTOR RELATIONS: Thanks, Fas. So we'll be taking questions over Zoom. We've got some pre-submitted questions to get through. If you'd like to ask a question, can I ask you to please use the raised hand feature. I'll announce you, and you'll be able to unmute your line before talking. Alternatively, there is the Q&A feature where you can submit a question, and I'll happily read it out on your behalf.

We do have one first pre-submitted question that I'll read out while people are getting a chance to put their hand up. So just on the derecognition that you announced today, Fas, how will that affect your issuance plans for Tier 2 and MREL if at all?

FAISAL YOUSAF: Thanks, Greg. Perhaps in answering that, perhaps I'll take a step back and just explain why we made the decision today and a little bit about the background. So as you know, Greg, and I think many people on the call will know, we undertook a liability management exercise on the securities in '22, which allowed us to reduce the overall stack from around $6.7 billion to the current level, which is $4.3 billion. So, we took out about a third, and a number of that was through participation from our core investors.

We would've ideally liked to have that number be higher, but in looking at it after the event, we realised that a good chunk of the issuance sits with investors who are either unable to sell or unwilling to sell. We were at the point where we've continued to evaluate it since '22, and these securities will, at the end of the grandfathering period, the CRR grandfathering period, as I said in the prepared remarks, in June '25, would have posed an infection risk. So, we took the opportunity now to take the action and derecognise them. That was in liaison with the regulator, getting formal permissions, and was an internal call.

In doing that we had actually prepared for a long while – we do these things over a number of quarters in terms of our overall Tier 2 stacks – so to the question that's been asked, it won't affect our future issuance plan. We'd already prepared for the actions that we've taken today, and indeed we wanted to take these actions today to provide clarity as quickly as possible to our investor base and to remove any questions about the infection risk that would've arisen had we not derecognised the securities. So, no changes to the funding plan – overall very comfortable with where we are in Tier 2.

GREG CASE: Thanks, Fas. So the next question comes from the line of Dan David at Autonomous. So Dan, if you want to unmute, you can ask your question.

DANIEL DAVID, AUTONOMOUS: Congratulations on the results and thanks for taking my questions. I have three. The first one is just on legacy and just touching on some of the points you've just made. I'm interested, noting the derecognition, how should we think about these bonds now in resolution? What are they treated as? I guess why I'm asking is, is the Bank of England happy with you including these bonds as non-regulatory capital and MREL; i.e. are they pushing for you to reduce further rather than just to put them in a bucket, which gets rid of infection risk?

And then maybe adding to legacy, in the past you've mentioned your priorities here. I think that the sterling make-whole, the "5.844s", is the most focused on or most talked about bond. Is there any update with this, given you made whole with the dollar last year?

The second one, on a slightly different topic, which you might be pleased to hear – one of your large Swiss peers brought up the subject of double leverage again, and I know we've talked about this in the past with HSBC. Looking at your accounts, I know that double leverage looks to be above 100% just at a high level. Is this being managed to that sort of level? Is this a priority for the PRA and what are the limits here?

And then finally, more broadly, on one of the popular topics, I'm looking at slide 39 and the CRE exposure in Hong Kong. I note the comments on the call earlier. I'm just interested if you could give any guidance on where you think that stage three ratio could go and also the balance in Hong Kong ex-China – is there going to be a further push to reduce that balance? Any information would be interesting, thanks.

FAISAL YOUSAF: Okay, thank you, Dan. There's quite a lot there, but let me try and unpack it and give you answers to all three of your questions. So starting with legacy – so I'll take it in the order you've given the questions. Starting with legacy and the derecognition, the way we look at these securities is we still believe these securities will be able to absorb losses in resolution. That's always been the case and nothing has changed from our perspective. We've had to take the actions we've taken today to avoid the infection risk – that would have been automatic in June '25 – but it's still our belief that they're there to absorb losses.

In terms of the other part of that question, which is interactions with the Bank of England, yes, we have been interacting with the Bank of England. We've done this – we've sought the necessary approvals to do what we do, and we continue to liaise with the regulator on all such matters. The Bank of England, though, are keen, as we are, for us to reduce our legacy stack, and perhaps I'll use this to jump onto the next part of the question, which is that we've taken a number of actions over past three years, really since the beginning of '22, to reduce that stack. It's gone from in excess of $14 billion to just over $7 billion now, and we're committed over time to continue that reduction, but we've always said that whatever we do needs to be appropriate and proportionate, and that's the same language and form of language that the Bank of England uses on such matters.

So when we look at the securities in our legacy stack – we'll evaluate them as time goes, and we've taken actions. You talked a little bit about if the security that we called in September of last year – so that was a make-whole security with a coupon in excess of 10%, and in evaluating that we looked at a number of factors. We looked at the coupon, the economics around it. We were also very conscious about our investor base and the sentiment coming from our investor base. The economics, though, are important, and we need to balance the investor sentiment with those of shareholders. In that case, for the holding issuance, dollar issuance, we were able to justify making the decision and calling the security.

At the same time, as you might imagine, we looked at the other one, the 5.844 that you've talked about, and the situation there was a little bit different, and I think it's probably safe for

you to assume without security the economics just weren't conducive at that time. Now, we'll continue to keep this under evaluation. We're quite aware that we've got a number of our core investor base in those securities, so we'll keep on evaluating it. That's a longwinded answer, but hopefully it's thorough enough for your first question.

I believe your second question was on double leverage, and my comment on that is we do use double leverage to reflect the fact that our subsidiaries often have higher capital requirements than they do when consolidated in the group. Our double leverage position really is not a concern for us. It's within our risk appetite and we expect it to remain there. We have had conversations over time with regulators, ratings agencies, all of whom are comfortable with the level that we run and indeed our risk appetite, and we align to PRA policy on the matter. The final thing I'd say is, in respect of double leverage, we do hold a significant amount of liquidity at the holding company, so that's in excess of $20 billion, and that's to manage any cash flow risk. So overall on double leverage nothing of concern from our perspective.

Then finally, getting on to your third question, so CRE in Hong Kong and the overall stage three balances, as I think your question alluded to, the stage three balances have picked up in 2024. We reported 2.4% of gross loans as stage three, but that did not impact our overall ECLs materially, and that's largely because the books that we have in Hong Kong CRE have a low LTV and therefore, although they go into non-performing, they don't lead to or haven't led to credit losses, and overall the book – we're very comfortable with the nature of the book in our Hong Kong business. I think that's probably answered your question, but I'll just open it up to Greg to see whether he wanted to add anything to any of that, in particular the CRE piece.

GREG CASE: No, just, I guess, one note on the path of the NPL ratio. It will always be relatively hard to predict because obviously it's inflows and outflows. You'll see in the fourth quarter, for example, that there was a small inflow in Hong Kong commercial real estate to stage three. It was lower than we'd seen in Q2 and Q3, but we did have some write-offs in the mainland China real estate book, so it really will be a game of in and out, but we do have our eye very clearly on it.

DANIEL DAVID: Thank you.

GREG CASE: Thanks, Dan. So, we don't have any raised hands at the moment, so please do raise your hand if you do have a question, but in the interim we do have a written submitted question from Lee Street at Citi. Sorry we can't hear your voice, Lee. So two questions for you, Fas. So, firstly, from a business model perspective, can we presume that the current Group is close to an end state – i.e. we should not be expecting any more significant disposals and any acquisitions? Would small bolt-on acquisitions, i.e. less than 5% of group assets, be something you'd look at?

FAISAL YOUSAF: Okay, so thank you, Lee. The way we think about acquisitions or actually surplus capital was laid out by Georges in the meeting earlier today, the investment presentation to analysts first thing this morning. We talked about using that capital in three real ways: first of all, to pay our dividends; second, in terms of the growth of balance sheet; and thirdly in terms of buy-back or acquisitions, and really that was the order of prioritisation. The way we think about acquisitions in general is that any acquisitions we make need to meet the return hurdles of the group. We'll need to consider the impact in terms of management overhead of any acquisitions and the ease or otherwise of integrating anything within HSBC. We've always said we are open to consider bolt-on acquisitions, but only if they make sense for HSBC, so nothing has really changed there.

In terms of the other part of your question, if I caught it correctly, the cost piece, [inaudible] is two parts to our cost plan, so we intend to take $1.5 billion out in terms of cost efficiencies within the group, and that will go straight to the bottom line in terms of saves for the group as a whole, but we also announced a further $1.5 billion, which is around streamlining some of the activity that we do within the group, repositioning businesses, and that is work that is ongoing. Pam listed in her set-piece presentation this morning two or three examples. We announced, for example, that we were disposing of our retail banking operations in Bahrain, and we announced earlier this year that the French insurance business will be an area that we look to dispose of. That's in addition to prior disposals in '24.

So there continues to be a focus on things that will benefit the group strategy in terms of acquisitions or disposals and really we'll announce them when they come.

GREG CASE: Thanks, Fas, and Lee's second question is: can you share your thoughts of potential inclusion in EM indices? Based on the split of your total assets, do you see this as likely?

FAISAL YOUSAF: I might ask you to answer that question, Greg, because I know you've been looking at it for us, so do you want to take that one?

GREG CASE: Yeah, sure. Thanks, Fas. So on this point we have had a number of conversations with various index providers and we are very cognisant that the primary index that's in people's minds is the JP Morgan so-called "JACI" index that one of our notable peers entered a couple of years ago. From our standpoint, as we understand it, the main yardstick they are looking at is the proportion of our total balance sheet that sits in EM countries. Now, you can look at that in a number of different ways, and of course JP Morgan will do that in their way. As we understand it, at this stage we are not at the level at which we would be eligible for inclusion, but of course that decision will always be down to JP Morgan, as they consider the balancing and the weight. So, yeah, we'll wait and see on that, and nothing new to give you there. Of course, I'm sure JP Morgan would be happy to have that conversation with you, if you need to.

Just polling again if there's anyone who wants to raise their hand to ask a question. I do have a couple of pre-submitted questions to get through, but I can see that Rob Smalley at Verition has just stuck his hand up. So, Rob, you can unmute your line and you should be able to speak.

ROB SMALLEY: Hi, thanks for taking my question. Just two really on the real estate. First, on Hong Kong, you talk about the unsecured portion, which appears to be long-held properties, probably generational. Despite the fact that interest rates have gone up and there are some questions about some of these buildings, have those entities – families, etc – who have owned these properties for quite some time, made a commitment or at least indicated that they're willing to support these properties through an interest rate environment? If not, you talk about low LTV and that these are secured. If they do in fact want to negotiate handing over the keys or some other kind of arrangement, are there other buyers for these kinds of properties in Hong Kong today? I could use a little education on that.

And then second question is on UK opportunity. Ring-fenced margin is pretty wide. What do you see the opportunity there in terms of the go forward? Is it margin expansion? Is it product expansion? Are there some geographies or segments that you don't feel like you have enough market share? If you could outline that, I'd greatly appreciate it. Thanks.

FAISAL YOUSAF: Thank you, Rob. That's very clear. I'm going to ask Greg to take both questions.

GREG CASE: Yeah, sure, of course. Thanks, Fas. Just on the Hong Kong piece, this is a wide and varied book. Pam went through some of the details of it, Pam, our new CFO, on the call this morning, but, just for background, a few points. As you noted, 54% of the Hong Kong domestic book is secured and the remainder is unsecured. The secured piece is where we've typically seen the flow into stage three so far, and the LTVs there remain strong. So in the impaired book, which was around 4.6 billion at the year-end, 58% LTV on that component, and that's clearly why you've seen very, very minimal levels of ECL coming off those flows into stage three so far.

To give you some context in terms of the next stage up in terms of credit criteria, what we class as substandard, so the credit grading just above impaired – that book right now is about $3.7 billion and has a 46% LTV, so again, to the extent that we see further deterioration in ratings and a potential move into stage three, we do continue to have pretty strong LTV protection.

The unsecured piece, as you note, is more toward the conglomerate-type large developers, who are often listed and well rated. In fact, 90% of that book, as it stands, is currently rated equivalent to an investment-grade rating with an external credit rating. So in that book what we've seen is typically quite a competitive market to lend to those types of names, and I think we're more than happy to continue to support that sector. So I'll leave it at that at this stage.

ROB SMALLEY: That's very helpful. Thanks on those.

GREG CASE: On the UK opportunity, yeah, look, I think we feel well positioned. We've got a great business in the UK. It's efficient; it's been taking market share; and I think it feels pretty

well placed to compete, particularly for internationally orientated corporates who have that tilt towards Asia in particular but any form of global exposure.

I think where do we see opportunities? I guess some areas where we are underweight right now – so SMEs is somewhere we're looking at for opportunities, but I think we want to continue to generally play to our strengths, and that is in writing high-quality mortgages on a good risk-adjusted basis and continuing to service those corporates who value what we can offer in the international space.

ROB SMALLEY: That makes sense. Thank you.

FAISAL YOUSAF: Thank you, Greg. Actually, I might just add a few comments on Hong Kong more broadly. We have, as you know, Rob, seen headwinds in the Hong Kong commercial real estate market, where some of our clients have faced some debt servicing challenges, but there's a number of things that provide reasons for optimism. Hong Kong has proven over some time how highly resilient it is, and there are a number of new growth areas that are emerging. It continues to offer a bridge, for example, for outbound revenue from China to the rest of the world. Hong Kong is building stronger links across ASEAN and also the Middle East.

We know about its status as a financial hub and the regulatory foundations, but also, as was called out in the call this morning, we see a number of structural opportunities in wealth management, and we believe Hong Kong is really well positioned, actually, to become the world's leading cross-border wealth hub over the next decade or so, so HSBC is well positioned to capture those opportunities as they arise.

As rates start to go down, it's my expectation that that pressure on clients that are facing debt service challenges will relax somewhat, so we'll keep an eye on that, and we're here to support our customers through that journey. I just wanted to add that in terms of Hong Kong.

ROB SMALLEY: I greatly appreciate that. Thanks.

GREG CASE: No problem. Thanks for your questions, Rob. We do have another pre-submitted question from Paul Fenner at SocGen. So a few here – we've answered a few of your questions already, Paul, but there's a couple to pick out. So, firstly, what currencies are most attractive to you for funding at the moment?

FAISAL YOUSAF: So, as I said in my prepared remarks, last year in senior holdco and MREL we issued about two-thirds in US dollar, and US dollar is still the largest currency by far and will continue to be, given the liquidity in that market. However, we are always looking to see opportunities to diversify, especially when the funding spreads are good. I think this year we'll be looking at the usual markets, so sterling, euro, potentially Swissy, Sing, Aussie as areas where diversification could occur.

On AT1, I would say we've probably got a strong preference for US dollars largely because of the FX exposure that it generates, and when we don't use FX – so where we don't go for US dollar and we have some cross-currency risk, it will be where we have the opportunity to downstream into an entity that has a functional currency that matches the AT1 that we issue.

GREG CASE: Thanks, Fas. Paul's second question is: non-NII makes up the lion's share of revenue still. Non-NII clearly is the growth area. What's the right percentage of non-NII versus NII in the medium term and what does any shift mean for RWA and capital needs?

FAISAL YOUSAF: Okay, great question. So at the moment we're about two-thirds NII, one-third non-net interest income. We do see opportunities for growth in non-NII. We've guided, for example, to double-digit wealth growth. The RWA and capital needs will be dependent on factors such as balance sheet growth more generally. So, look, we're not putting a specific target on the split between the two, but certainly we see opportunities to grow our non-net interest income in the future.

GREG CASE: Thanks, Fas. We do have another question from the line of Dan David. Dan, you should be able to unmute your line.

DANIEL DAVID: Apologies, back again. Thanks for taking my additional question.

FAISAL YOUSAF: No problem.

DANIEL DAVID: Just after your comments on the issuance plan, I just wanted to touch upon one thing on the holdco senior. So in the prior years we've noted you've been a net-negative issuer; i.e. you're issuing less than calls and maturities, but this seems to have flipped this year. So I'm just wondering – I'm noting the big cash balance you have at the holdco. Is there anything driving this? Are you expecting MREL requirements to go up, for instance? I look at calls and maturities, and I see that '26 is down, so I'm just trying to understand why you're increasing issuance versus calls and maturities in 2025.

FAISAL YOUSAF: Thank you. Thank you, Dan. So, yeah, look, we're marginally net positive issuance this year, so we're guiding to issuing between 16 billion and 18 billion in senior holdco against calls of 14 billion, and on the AT1 it's around 3-4 billion against calls of 2.5 billion. So, yeah, look, net positive – that's really generated through nothing else than expected balance sheet growth and really, when we look at AT1, as well, I would say that it's not always the regulatory buffers that we're looking at there. We're also looking at where there might be opportunities to downstream some of the AT1 into entities that might have leverage ratio constraints. So those are the kinds of reasons that are behind it – nothing more than that, really.

DANIEL DAVID: Thank you.

GREG CASE: Thanks, Dan. So I think we've got no further questions at this stage, so I guess I'll just hand it back to you, Fas, to wrap up.

FAISAL YOUSAF: Okay, thank you. Well, look, thanks, everyone, for joining the call. I hope it was one you found useful. If do have any further questions, then please obviously don't hesitate to pick up with Greg and the IR team, and hopefully we'll see many of you on the road and through bilateral conversations over the next few months. Thank you.