Stock Market Review

# Changing the guard at HSBC Bank Malta plc

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Following the detailed interim directors statement published on November 15, I set up a meeting with the outgoing CEO of HSBC Bank Malta plc Alan Richards to delve deeper into some of the important revelations made in the interim statement, mainly related to the restructuring exercise being undertaken, the outlook for 2012 and the serious developments that are gripping the eurozone debt markets.

It so happens that HSBC Malta CEO designate Mark Watkinson was on a short familiarisation visit to Malta ahead of his commencement in his new role on January 1, 2012. The interview was therefore conducted with both the outgoing CEO and the new CEO for HSBC Malta.

HSBC's detailed interim statement indicated that during the second half of 2011 the bank continued to de-risk its investment portfolio by reducing the bank's exposure to sovereign debt of southern Europe. At the start of the interview, outgoing CEO Alan Richards confirmed that during the second half of 2010 HSBC had taken a decision to gradually reduce its exposure to the higher risk countries across the eurozone in view of the deteriorating outlook. Mr Richards explained that HSBC gradually started the process during the second half of 2010 but sold off most of these government bonds during the first half of 2011 and closed off the position during the recent summer months.

Mr Richards commented that the bank's "available for sale" portfolio "has been cleaned up". HSBC are of the view that the eurozone debt crisis "has still a long way to go" and this reduction in exposure puts HSBC in a better position to protect future shareholder value. The balance sheet of HSBC Bank Malta also includes the portfolio of the life company under a different classification of "Fair Value Through Profit or Loss" (FVTPL). Mr Richards noted that the portfolio of the life company retains a small holding of Greek government bonds and this was not sold due to the deeply discounted price in the market. Otherwise, the outgoing CEO noted that "there are no other material exposures to the more problematic periphery countries in the eurozone".

The interim statement made reference to 2012 which HSBC expect "to be a more difficult year". The outgoing CEO believes that in 2012 "growth across the eurozone is expected to stall and given that Malta is a small trading nation with an open economy, it will inevitably be impacted by the slowdown".

In view of the challenging conditions and in order to ensure that the overall profitability level is sustainable in the coming years, HSBC Malta are focusing on the cost side of the business to compensate for expected weaker growth in revenue. In the interim statement HSBC announced that a bold decision was taken to embark on a restructuring exercise to deliver sustainable cost savings. These cost saving initiatives mainly involve a scheme for early retirement that is expected to lead to an initial one-time cost of up to €10 million. While it may sound strange to shareholders that the one-off hit is being reflected in this year's financial statements while the measures will take place in 2012, Mr Richards explained that "this reflects the prudent approach taken by HSBC as well as being in line with accounting standards".

Incoming CEO Mark Watkinson seems to have already been well briefed on the bank's plans for 2012 and although he did not delve into the finer details of the restructuring taking place, he commented that the off-charge of up to €10 million "should be considered as an investment which will be repaid within a relatively short period of time of circa three years".

> **HSBC had taken a decision to reduce its exposure to the higher risk countries across the eurozone**

Another aspect being looked upon is the card acquiring operation related to the EPOS terminal business. A separate company announcement had been issued on October 28 informing the market that HSBC "is in discussions regarding the possible sale of its card acquiring operation". Mr Richards explained that while the issuing of the debit and credit cards will continue to take place at the bank, the "acquiring" aspect is not considered to be a long-term strategic business for the bank and therefore HSBC is in discussions to sell this operation "to a third party card acquiring specialist".

Such an initiative was also adopted by HSBC in other countries and Mr Watkinson, who in the past was responsible for HSBC's operation in the Philippines, confirmed that a similar disposal took place in the Philippines a few years ago. When asked for further information on the basis of such a decision, Mr Richards noted that HSBC does not have the technology and infrastructure that is necessary for taking such an operation forward in the coming years. When questioned on the overall financial impact of this potential sale, the outgoing CEO was reluctant to provide finer details since the actual sale has not materialised. However, he immediately confirmed that the financial statements will be positively impacted though the realisation of "a good chunk of goodwill in the event of a successful outcome".

**Alan Richards and Mark Watkinson.**

Another topic that was discussed was the well documented regulatory implications following the recent EU summit and the required measures by the European Banking Authority. The EBA recently announced that European banks have to achieve a Tier 1 capital ratio of nine per cent by June 2012. Mr Richards pointed out that historically "HSBC Malta has always been well capitalised and in conformity with minimum regulatory requirements". When questioned on the current Tier 1 ratio of 6.7 per cent for the Malta subsidiary, the outgoing CEO explained that their understanding is that the higher level of Tier 1 capital stipulated by the EBA is applicable to the HSBC Group as a whole and not to a subsidiary level. As at June 30, 2011, HSBC Holdings plc, the parent company of the HSBC Group, had reported a Tier 1 capital ratio of 10.5 per cent. Mr Richards confirmed that discussions with the regulators are still taking place, "although no definite stand has been confirmed by the European Banking Authority on the matter".

Before concluding the interview, reference was made to the repeated calls by the Central Bank of Malta for banks to increase their provisions against potential losses in the loan book. Mr Richards explained that HSBC Malta's overall level of provisions for non-performing loans "has always been conservative in both good economic times and bad times". Mr Richards also referred to the initial "cleaning out exercise" that took place immediately after the purchase of Mid-Med Bank plc. The outgoing CEO explained that following the take-over, HSBC then adopted the stricter credit conditions "in line with overall group policy". Mr Richards made reference to the "remarkable stability in the retail loan book" but acknowledged that "some pockets of pressure were evident in some commercial sectors, notably in construction and retail". On his part, Mr Watkinson confirmed that the provisioning required for 2011 "is expected to be broadly in line with last year" when a total of €5.5 million in impairments were recognised.

In his concluding remarks, Mr Richards singled out Malta's overall economic resilience in the recent turmoil and confirmed that "despite the extraordinary challenges during 2011, the bank performed in line with expectations and this should not be significantly different in 2012". The outgoing CEO acknowledged that a prolonged low interest rate environment is not an ideal scenario for any bank but "once interest rates increase from their current artificially low levels, HSBC Malta is very well positioned for the future".