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Barclays Global Financial Services Conference

Tom King, CEO Investment Bank

[This transcript has been edited by the company]

It's my pleasure today to introduce Tom King, the CEO of the Investment Bank. And Tom is also our first keynote-presentation in Q&A. I work with Tom on our Investment Bank Executive Committee, and I get a close-up look as to the changes Tom has made, and how he's operating as CEO. I'll have a few more words to say about that in a few minutes.

Tom's had over 25 years in banking. He started at Salomon Brothers in 1989, spent pretty much all of his career advising clients. In this role, he's worked with some of the largest companies in the world, across equities, across debt, M&A transactions and assumed the CEO role at the Investment Bank in May of last year. Prior to that, he ran banking both globally and in Europe.

Before we get into the Q&A, I'd like to invite Tom up to give us a few words. Thanks.

Tom King, CEO Investment Bank

Thanks, Larry. I appreciate that and welcome, everybody, on behalf of everybody at Barclays, to the conference. It is great to see such a fantastic turnout.

So I've been Chief Executive of the Investment Bank for a little over a year and a half. It's been a very challenging time to take over the Investment Bank. But also, I think a really interesting time, as we face down a generational change in the regulatory environment.

We've made some big changes in the Investment Bank. I think we've taken very decisive action and I think we've done it after really looking at the business in a deep, analytical way, and I think taking a very sober look at the industry.

While we have more to do, particularly on the execution side, I feel great about where we are. I look at our product set; I look at our footprint, and particularly the management team and the executive committee that we have collectively owning the business and running the business, I feel really confident in our future.

So what I'd like to do over the next few minutes is really talk about the changes that we've made in the Investment Bank, and why we've made them. And then Larry will come back and we'll do Q&A.

Put simply, the strategy that we are deploying is about returns. It's about driving a return on equity in excess of our cost of equity. I know there's probably no bank that doesn't say they're run for returns. But I assure you, it is a very difficult thing to turn away that high-revenue low-ROE trade, when one of the things that gets looked at every quarter is your year-on-year revenue projection. To really create value in this business, you have to run every product, every geography, for returns. And that's what we're going to do.

You all know that our industry is in the midst of very significant cyclical and structural change. These changes have put an enormous amount of pressure on not just us, but everybody's ability to generate sufficient return on equity. What I'd like to do is give you a little bit of background in terms of how those industry impacts have felt to us at Barclays.

We, along with virtually everybody in the industry, have been very aggressively managing down our risk weighted assets in anticipation of CRD IV or Basel III. At Barclay's Investment Bank, we have taken our risk weighted assets from £191 billion to £140 billion from 2010 to 2013.

But when we fully implemented Basel III at the end of last year, we remarked that £140 billion of risk weighted assets back to approximately £220 billion. So the implication of that, for us, was that the equity allocated to the investment banking business increased by 50%, overnight. Just at the time when the denominator in the ROE calculation has gone up by 50%, there was very significant pressure, and is significant pressure on the numerator to the ROE equation - the profit.

The pressure comes from both cyclical things, like we're right in the midst of decade-low volatility, as well as structural changes. We're exiting businesses because of the Volker rule. We have certain businesses, particularly in the macro space, that just don't work as well in a CRD IV leveraged-balance-sheet world.

So the strategy refresh that we announced in May was really designed to address the ROE equation in a holistic way; numerator and denominator. But in a permanent and strategic way.

As we began working through the strategy refresh that we announced in May, one of the things that was clear is that we were solving a problem that had multiple constraints.

When you have a problem with multiple constraints, you have to have some overarching principles. For us, those overarching principles were first to create a business that's strategically coherent, meaning you're delivering what your clients want and need and expect from you, but also a business that can earn an ROE in all parts of the cycle. Second, we had to have enough capital to be competitive, but not so much that we couldn't earn an ROE. Then finally, we wanted to focus on products and geographies where we had a distinctive advantage.

So in order to solve for returns, the first thing that we needed to do was really reshape the Investment Bank's balance sheet. In a sense to recapitalize the Investment Bank. So we separated the Core business from the Non-Core business. We went through and did a very rigorous analysis, business-by-business, RWA-by-RWA, of what was Core and what was Non-Core.

We separated out the non-strategic businesses. We separated out the non-strategic assets. And we moved £90 billion of risk weighted assets from the Core into the Non-Core. By moving these low-returning, non-strategic risk weighted assets, the equity allocation to the Investment Bank was reduced very significantly.

Now those assets are still within the Barclays Group. We set up Barclays Non-Core really as a factory for the accelerated rundown and divestment of those assets. That business is being run by Eric Bommensath, my former co-CEO, and he's doing a fantastic job.

Last quarter, we reduced risk weighted assets in the Non-Corebusiness by £22 billion. What that's left us in Core is, we have about 30% of the Group's capital; down from over 50%. We have £120-125 billion of risk weighted assets. And we have an equity base off of which we can earn a return. So that's sort of the denominator portion of the ROE.

I think the more interesting piece is really the numerator. What's our strategy for how we address the Core IB revenue and cost issue? Given that our capital allocation is roughly fixed, the key to our success really is how we drive the numerator.

So I like to describe our strategy along five pillars. The first of which is that we're reweighting our businesses toward the integrated origination verticals of Banking, Equities and Credit. Credit, including munis and securitization. These are the businesses where you have both primary issuance and secondary trading working synergistically together.

In one of the meetings this morning, I used the example of an IPO inside the equity vertical. It's a perfect origination example, because it cuts across the entire firm. You do an IPO, it touches coverage bankers, ECM bankers, syndicate, sales, trading, research. And it touches a lot of people, but it doesn't use a lot of capital and it actually creates franchise value.

You do the IPO, you're in position to get the secondary blocks. You're in position to be the ax in secondary trading. In the UK, you're going to be the corporate broker. Hopefully, you're in the boardroom, so you're positioned for the M&A. You get a credential to help get the next IPO. It creates real ongoing franchise value.

The second pillar is really around our FX and rates business, which we've consolidated into a single Macro sales and trading vertical. Now importantly, we're not exiting the Macro businesses. We're simply repositioning the businesses, and we're moving away from complex, long-dated non-clearable, non-collapsible transactions to the shorter tenor, clearable things. We're deploying much less capital in those businesses, but keeping ourselves in position to capture volatility when and as it returns to the market.

Importantly, we have retained our ability to do the complex things and the bespoke things. But we're doing it off a single desk, where we can actually make sure we adhere to the appropriate return parameters.

The third pillar is really the centralized use of the balance sheet. Now one of the things that I found when I became CEO of the Investment Bank was, there are lots of ways for a low-returning trade to come into the Investment Bank. Lots of doors it can get in through.

So we created a single utility to control the balance sheet. We call it CCM - Client Capital Management. Whether it's a relationship loan, a piece of prime balance sheet, a derivative trade, it all has to meet strict return criteria.

We think centralizing the use of balance sheet can be a key differentiator for us, in terms of generating returns. And having a center of excellence to optimize this precious and scarce resource, we think, makes a lot of sense.

The fourth pillar is really costs and we started this journey long ago, but we've continued to accelerate our cost journey with a particular focus on retooling ops and tech. We're simplifying our product offering. We're consolidating our product offering, which should enable us to simplify our infrastructure and take costs out structurally.

Back to the Macro sales and trading vertical, it's a good example, where we are going to run that, as opposed to running it off multiple technology stacks, we'll run it off a single stack.

You've also probably heard us talk about headcount. At the strategy update in May, we said we would take 7,000 headcount out between Core and Non-Core over the next three years. We'll, we've taken 2,700 headcount out, gross, so far this year. You'll see some of the benefits of that starting to flow through our P&L. And even the first half of this year, you saw our operating expenses down 8% year-on-year, despite litigation charges going the other way.

Finally, the last pillar is really around reinvestment. So while we have to be incredibly disciplined on costs, we can't find ourselves getting to a spot where we're earning an adequate ROE with no growth. Because we just don't think that will command the valuation that we want.

So we are continuing to reinvest in the business. I gave an example this morning, in the last quarter, we hired 13 investment bankers into the IBD division - Managing Directors. Again, we've just got some new research hires that are coming on, as well. So we are reinvesting in the business. But I think it's important to say we're only going to allow the reinvestment or retain that right while we're very aggressive with the overall cost picture of the bank.

So before I invite Larry back, I would just like to leave you with a couple of thoughts. The strategy that we've chosen was one where we stopped, stepped back, and looked at the environment we're in. Again, this is a generational change, in terms of the regulatory environment. We think we've picked the strategy that works, and works in a world going forward.

We've obviously been out to see investors, we've been out to see the research community. They, in particular, reassuringly – literally, nobody has said, "Well, you've done too much" or, "You haven't done enough."

We still have to execute from here, and we understand that. But we think the strategy is already working. We're off to a great start. We had a terrific second quarter. We have scale and leadership in the Macro businesses. We have a top-five position in the US IBD market, a very deep and important market. Top 2 fee positions in the UK market. Our Equities business in the second quarter had its second best quarter ever. Our ECM origination business: we did 25% more trades in the first half of this year than we did in the prior year. So we're off to a good start.

2014 is obviously a transition year for us and we've said that before. But we like the progress that we're making. We feel confident in the strategy and we will get to that ROE target.

With that, let me invite Larry back for discussion.

Larry Kantor:

Okay. Thanks, Tom. Just to say, let me just make a few observations as a front-row participant, before I get to chatting with Tom, here. I'm on the Investment Bank Executive Committee, as I said before, which Tom leads and I can honestly say that the management of the Investment Bank is working better than it's ever worked since Tom took over.

First of all, I have to say it's nice having a single CEO, rather than co-heads. For me, personally, reporting to one person instead of two makes life a lot easier. But more importantly, it really does lead to more effective decision-making.

I'm sure you've all read, we have had a lot of, or a large number, of high-level departures. This is part of Tom's process of streamlining the management structure. I have to say that it is healthy, and one might argue, even necessary to get some people in there that are open to change and willing to execute different strategies in a world where we all know, as Tom just described, that's exactly what we need to do in the new market and regulatory environment. We're no longer running this business in silos with FX and Rates and Banking and Commodities; we're running it now in an integrated fashion.

And that new strategy that you heard on May 8th, this was done collectively with the ExCo. It wasn't just Tom driving it or Antony, it was all of us holding hands together and we said, "This is what we've got to do." Including, for example, Eric Felder, who runs the Markets business, was fully onboard with consolidating that business, so we could create the room to invest in Equities, Banking, Credit and so forth, and follow through on our origination strategy. In short, I just want to say we are all really excited on the management team, throughout the bank, to get on with it and to execute our new strategy.

I'm going to, now that I've said these nice things, badger Tom with some tough questions. Then, we'll have a little time to open it up to the audience, because I know there's a lot of questions we all want to ask.

First of all, I just talked about management changes and we have had a lot of change at that level. The big question: are you pretty much settled on your management team? I, of course, have a vested interest in the answer to this question.

Tom King

Larry, your job is safe if that's the question. No, we absolutely are. We really as part of the May announcement worked with the Board in terms of what was the right team and the next generation to take us through the next wave. There's a lot of tenure inside the organization and the management team, but people do have new sets of responsibilities. And I appreciate what you said about the team working cohesively together and one of the things that I will say that I do think is different about the way we're running the organization. Those old businesses of IBD, FICC, Equities and Research - those silos are completely irrelevant. We have to run the business in a uniform way, and the IPO example that I used really brings that home. It cuts across not the verticals, but the horizontal and we've made a bet on a fixed amount of capital that we're going to deploy in the business. We have to have the fungibility to say, "Well, the opportunity is in Rates." Or, "The opportunity is in Credit." Or it's in distressed or it's in the leveraged-finance book and to move capital around as a team. The IB ExCo is set; the strategy is set; it's really about executing from here.

Larry Kantor:

Great, so let me get to a little more difficult question. We've all read some things in the press about Barclays - I'm glad there's nothing today, it seems like it comes quite frequently. Dark Pools - any comments about the Attorney General's charges on this?

Tom King:

Well, the Attorney General raised a very serious allegation, which we always take those things incredibly seriously and if we had done something wrong, we have to make it right. With the dark pools, we spent an enormous amount of resources, internal and external, really pulling that business apart, to make sure that that business did what we said it was doing.

Maybe unlike some of the other things, we got to a place after a month of study where we said, "We just don't think the allegations hold" and we filed a motion to dismiss. That's the first stage in what will probably be quite a process. But we're taking it very seriously, we are pushing back in that case.

Many of the things that have come up for the banking industry are really about conduct or conflict of interest. We've spent a lot of time really trying to put ourselves in a position where we don't have missteps in the future. So, "Conduct," is one of our main risk-pillars and we've used a conflict of interest framework that's very well developed in certain parts of our business, and stretched it across the entire business, to try to avoid those things in the future.

Larry Kantor:

We're certainly spending a lot of time on ExCo, discussing these things and making sure these things don't happen in the future.

Tom King

We are.

Larry Kantor:

I think another thing on everyone's minds here is current performance. Is there anything you could say about what's happening in the third quarter? I think we have heard news across the Street about trading volumes being down, for example.

Tom King

Well, I think that we are in a cyclically slower part of the year. I think you can observe the Dealogic issuance volume in August was a slow month. But for this quarter, it usually is about September and it's very, very early days, but September seems to have the hallmarks of what could be a nice, attractive month. We're seeing a little bit of volatility in the trading businesses and the issuance calendar is robust.

So cyclically slow in the summer. I think Tushar had mentioned that July was a tough month and volumes were light in August, across the opportunity set for everybody. But it's always about September, and it's early-days, there.

Larry Kantor:

So, cost. We talked about the need to take our cost-base down. You talked about headcount. Any other cost-initiatives, structural cost-initiatives, that you can talk about?

Tom King:

Sure. Well, if we're going to run the bank for ROE, which we are going to, we only have so many levers. So we've made a bet on capital, and that's relatively fixed. Revenue is not fully in our control. So we position ourselves against the opportunity, and we think we can continue to take advantage of the marketplace, and even gain share, particularly where we've made big investments that haven't yet been monetized, like European Equities. But revenue is not completely within our control, so the only other lever on ROE is cost. We're moving very systematically through our cost-base. We've exited some businesses, we've resized some other businesses, we're in the midst of a significant retool around Ops and Tech, where we're consolidating technology platforms for simplifying our risk capture platforms. And we're likely to see the benefits of those flow through our P&L as we move forward.

The thing that you have to understand about the cost base of an Investment Bank is in a down revenue environment, operating leverage is your worst enemy. And in an up operating environment, it's your best friend. So we are very sensitive at the PBT line in terms of what's happening at the revenue line, because costs move slowly. We have capitalized so much of what flows through in any accounting period, including your people, right? Deferred bonuses are just another way to capitalize your people.

But we are taking a long-term approach on cost. We know it's the only thing we can really control once we've made our bet on capital and we're getting after it.

Larry Kantor:

Right. So let's turn to the strategy a little bit. Another question that maybe we're all thinking about, here. Barclays really built itself as a FICC powerhouse. Now it seems as if we're deemphasizing that area and emphasizing other areas. If that's the case, what makes you think we're going to be successful in pulling this off?

Tom King

Well, I wouldn't necessarily characterize it as a radical deemphasizing of the FICC business. It's true that Barclays started as a balance sheet-driven wholesale FICC sales and trading house. The rules have changed very radically. I think that Barclays and the Board have been changing with the changing environment. In fact I would argue Larry, that we've done more than almost any other bank to address where we were at the starting point, and how the world was evolving. The acquisition of Lehman Brothers was really the first stepchange towards creating a more balanced bank. The buildout of the Equity business, the buildout of the IBD business on the back of the Lehman acquisition, globally. The way I would describe our strategy is another step on that journey. It's probably another kink in the curve, in terms of emphasis. But we were, even just a couple of years ago, very, very, very heavily weighted toward the FICC business. And now we're in the last quarter, over 60% Equities and IBD, relative to the FICC business. So it's a much healthier balance. It's not to say one business is better than the other, but in different parts of the cycle, different businesses will pay and what we're trying to do is create a business that will work through the cycles.

We're not abandoning the FICC businesses; capturing that volatility and being a player in Macro is hugely important and a year from now, when we have a very different macro environment, I think we're going to be very happy that we didn't throw the baby out with the bath water.

Larry Kantor:

And I think it's not only balance, right, Tom? I mean we are starting to see the benefits of this origination-led strategy.

Tom King

Oh, absolutely. I mean I think we've got great origination franchises. With rates where they are and volatility where it is, this is an issuance environment. That won't be where we're always at.

Larry Kantor:

Right. The macro environment. What are you seeing there? We all know that banking is leveraged to economic activity. What are you seeing out there in the macro environment?

Tom King

So I think we're moving into kind of a two-speed world, where in the developed markets, certainly the US and the UK look like they're outperforming. And the broader developed markets, particularly Europe, looks like it's underperforming. I think that plays into our strengths, given our dual home markets of the UK and the US.

But I think it also has some interesting implications for the trading businesses. I think as you start to see a differentiation in economic activity, it will drive differential activity at the Central Bank level. You can see that we're going to have some more interesting conditions from a volatility perspective. That may be helpful, in terms of sales and trading environment. Just the last couple of days, in terms of what we've seen in the P&L, it's been interesting.

Having said that, I think the big question is going to be, "When does the tightening cycle start, and how quickly does it go?" Certainly here in the US, we could find ourselves in a position where we're at full employment before we even start tightening. Typically, you want to be done with your tightening cycle by the time you get there.

I think the Fed would like us to believe that there's a very long runway and it's going to be a nice, slow, gentle tightening. We may get something that's more abrupt; which I don't think is necessarily bad. I think the sooner the Fed starts and the quicker it finishes, the lower the terminal Fed funds rate would be.

But having said that, I mean, you're probably holding your tongue, being the economist that you are. What are your thoughts?

Larry Kantor:

I think you have it right. I mean you look at this cycle, and one of the unique characteristics of this business cycle wasn't that we didn't - the US didn't - lead the world in recovery. It was really China and some other emerging markets. The US and the UK were in many respects the laggards. Now it does appear that they're leading the cycle, so I think that's right. And you can expect, I think, divergent monetary policies; certainly the ECB's going in the other direction and the Bank of Japan is going in the other direction than the Fed and the Bank of England.

Given especially that [volatility] is at historic lows, or has been around there, I think it's reasonable to assume we'll get that, which will help. I think the big question on everybody's minds, because we've had amazing financial market performance, will this tightening cycle end that? That's I think what the question is. I would say that in the early stages, the likely answer is, "No." Obviously there's going to be a lot of noise around the first tightening and so forth. It wouldn't be surprising to see a correction, but not the so-called "big one."

The way I look at it is, when the Fed's tightening, because growth's doing well and the labor market's doing better, that usually ends up being pretty benign. You see a little correction and things keep going. When they're out to kill inflation, if you have an inflation issue, that's when you want to head for the hills in terms of markets. Because the Fed will just keep going until the economy breaks or blinks. I don't think we're close to that environment at this point. So largely, I think we're in agreement on this.

In terms of the trading environment, would you characterize the issues that all the banks are facing as structural or cyclical?

Tom King

Well, I think it's both. I mean we are, as a bank, leveraged to the wholesale market in the trading businesses. So, if you don't see volatility in the markets, there's not much activity in credit, and government bond trading, or in FX. We are at a long-term cyclical low. I don't think that that is the "new normal," though, I don't think that that's what we're going to have for the rest of our existence but I do think you need to see some catalysts for movement. There's no question that a big part of this is cyclical.

But I do think that there are some structural changes that are fundamentally changing the business forever. The FICC business was largely created and driven, at least through some of the big growth phases, through the nuances of derivative accounting, where initially you could do a long-dated structured trade, NPV the revenue and not hold any capital against the risk that you owned for the next 10 years. Then with each iteration of the Basel rules, you held a little more and a little more and now you hold a lot. So those kinds of trades just don't work anymore.

Now as people come to grips with a return-calculus for their bank, everyone will contract the marketplace. And those trades will get done in a different format, whether they're clearable or compactable, they will get done in a different way.

So it's important, even though things will change, to retain the capability to participate in the new environment. Then of course there are structural things that will just never come back. So, prop - banks are going to take less principle risk; that's just true. I do think one of the things that banks have to be attuned to is making sure that we don't take so little risk that we can't earn a return.

In an environment like this, where we are going to take less macro risk, you've got to think about, within your overall risk-appetite, where does that morph to - do you take more idiosyncratic risk? So it's both, but with the reduction in leverage, some of the rule-set changes, the accounting changes, the regulatory changes, it's going to be a structurally less profitable industry. I think that's just true.

Larry Kantor:

Following up on that, if you look at our strategy within FICC, it's really what we're calling the Macro businesses that we're consolidating or repositioning: FX, Rates, Commodities - where are we on that, how far along are we there?

Tom King

Yes, so we're really quite far down the line. If you think about Macro businesses, where the revenue opportunity has really fundamentally changed, you have to look at that business top-to-bottom. Our paradigm was, "Okay, if this is the world we live in for the foreseeable future," not that I'm saying it is, but if you're planning that way, "what should you look like from a capital perspective, a headcount perspective and an overall cost perspective?" We've gone through and we've adjusted the business.

Now, capital is probably one of the easiest ones to start with and we've reduced capital again, so we've reduced headcount again. And we're in the process of consolidating our technology to run those businesses on a single stack.

So we've made good progress, there and while we're not necessarily seeing it show up in the P&L - because you don't get credit for cost cuts in the first year, sometimes it costs more to take the people out than it does to keep them, at least in the first year - that will start to flow through the business. But we've been very, very disciplined and Mike Bagguley who runs that business has really sat down and said, "Okay. Here's how we earn a return in this environment."

Larry Kantor

Yes, I think that's an important point, that the cost-reductions, you haven't actually seen it all flow through, yet, so I think that is worth keeping in mind. It's also important to note that we still - the environment won't last forever - we're still positioned to take advantage as the trading environment improves. So, I think that's key, also.

We've talked a lot about the Investment Bank, and the Investment Bank strategy. How do you see that fitting in with what's going on in the overall Barclays Group?

Tom King

Okay. That's a good question. I probably should have said something about the overall Group in my remarks.

So, what we announced in May was not just an IB strategy, but a Barclays-wide strategy. I think that we've created four chunky, coherent business units, and a Non-Core business whch I think simplifies Barclays immensely. I also think each business has a clear strategy and set of objectives. And each business is linked to the other, because we've pulled out the functions of running things like technology, legal and finance at a Group level. Those cost bases, we're going to try to get the most savings we can through consolidation.

But if you look at each of the clusters, there's PCB - Personal and Corporate Banking: there's a business that through impairment reductions and cost reductions, had mid-20s PBT [increase y-o-y in H1 2014]. Barclaycard: again, through a different mix, also creating a mid-20s PBT [increase]. The Africa business: by consolidating it and reporting it as a single unit, as it's reported on the Johannesburg Exchange, you really see the underlying growth potential and earnings power. Now we have a goodwill accounting that flows through our reporting of it, so it dilutes that a little bit, but you see the power of those businesses.

And for Barclays as a Group, then you have something that's much, much more balanced. So instead of an Investment Bank with high volatility, using 50% of the capital, you really now have four clusters, where from a PBT perspective, we're no longer even the largest cluster.

So I think it's really created a portfolio where you have businesses that are related, but act as a buffer for each other in different parts of the cycle. Then importantly, we've taken out all the Non-Core stuff from all of the businesses and put it into a single Non-Core unit. We put some of our very best people in charge of that, to focus and be incented toward running that down in a capital preserving way. But really, really turning that into a factory to get rid of the assets and free up the equity that's supporting that business so it can be redeployed; so it can be paid in dividends; so it can be used to improve our capital ratios.

I feel like it's a much more coherent strategy, and that Barclays is a much easier company to understand.

Larry Kantor

I'm going to ask Tom one more, I've got lots of other questions, but one more, and then we'll open it up to the audience. This may be a tough one: what do you want to have as your legacy? I mean I think every CEO wants to put their stamp on the company. It's a little unfair, because you've only been in the CEO role over a year, and as sole CEO, a lot less than that. But what do you want people to remember you for?

Tom King

So, Larry, I joined Barclays back in 2010, because I thought this was the most interesting and bold corporate finance project that I was going to see in my career. When someone's trying to create a global Investment Bank, a diversified global Investment Bank where there wasn't one, and nobody really has run that play successfully for a very, very long time. And I wanted to be part of that; I think that Barclays had all the tools to get there, particularly right after the Lehman acquisition. I thought I could contribute to that. It's been a fantastic five years and I'm incredibly proud of where we've gotten to.

But this is an incredibly challenging environment. And we're five years into what's a decade-plus-long exercise. So I want to put the right strategy in place; the right people. I want to be part of the execution of that strategy.

We talk a lot about Stewardship as a value, and leaving the place better than we found it. That's what I want my legacy to be. I want to come in and be part of what will hopefully be generations of people to create the next great Investment Bank.

Larry Kantor

Great, okay. Well, I've had my shot for a while, here. So anybody who'd like to ask a question of Tom. I think we have mics in the back. So just raise your hand; we'll get a mic to you. So if you'll put your hand up, we'll have somebody over there.

Audience Question 1

The PRA consultation on leverage suggests that the UK might be moving towards a 5% leverage ratio. What would a 5% leverage ratio mean to the strategy of the Investment Bank and the ROE of the Investment Bank?

Tom King

Yes, that's a great question. When we did the May strategy refresh, "Project Electra," as we called it, obviously, we had to take a view on where the regulatory environment was going. We assumed it wasn't stopping at 3%, and we assumed it wasn't stopping at 3.5%, which we should get to this year. We assumed it wasn't stopping at 4%. So whether it's 5% or north of 5%, we think that given a sensible glide path, we think we can get there without impacting ROEs.

We obviously are running the bank now with dual governors of risk-weighted assets and gross balance sheet. To be honest, I feel like we have more tools to play with, and it's easier to manage your way down on the leveraged balance sheet front than the risk weighted asset front. So we don't think that 5%, again given a sensible trajectory, is a crazy place to end up, as long as it's built into the trajectory.

Audience Question 2

Similar question: just in terms of other regulatory capital concerns e.g. risk-weights, AT1 being excluded, what are the things kind of that we'd be looking at potentially that could change your business?

Tom King

Yes, that's a good question, as well. One of the things I will say is, I think that over the last 12 months, our relationship and dialogue with our regulators has really improved. I think the potential for big surprises is significantly mitigated.

We'll continue to have puts and takes, but it will be a discussion, as opposed to waking up one day and having a big surprise. So we're always having discussions about model changes. About what capital should be included, what the adjustments to our regulatory equity should be.

But I think we're now at a place where there should be fewer surprises. So we don't do anything on the capital side, really, without beginning to have the discussion with our regulators. So we feel pretty good that we're building capital, that we have a trajectory and a relationship with the regulators, and that we won't get any surprises on that.

Audience Question 3

So I've listened to a couple other of your US competitors and their strategies. It's still not clear to me what you do better in the United States than the other US competitors. So succinctly, what is it that you're doing better and how will you distinguish yourself in the next five years?

Tom King

That's a very good question, in fact, one we got at the Board when we talked about the origination strategy. What I would say, you prefaced it specifically about the US, is to win on the origination side, which is really the driver, you have to have three things, some of which differentiate you and some of them don't:

First you have to have a balance sheet, because you've got to play in the relationship loans, you have to have the money in the bridge book, you've got to be able to bid for the secondary block. So you have to have a balance sheet that you're willing to deploy in a sensible risk-appetite. That's a minimum requirement, but it doesn't necessarily differentiate you.

The second thing you need to have, you need to have what I call the "proven product" set. You can't show up at an IPO pitch against Goldman and JP Morgan unless you've got 250 reps lead left on a billion-dollar IPO, and really have the credentials to get that business.

But then the last thing you need, and that distinguishes you from some, not all - the last think you really need is, you need a franchise. You need a long-term set of relationships with bankers who've been in their seats.

In the US, you really have a reasonably small number of banks that have those relationship franchises. So, in those places where we want to compete, we're comfortable going up against any of the big-name monoline or universal investment banks, and competing for business and winning business.

Now in the US market, we've got a natural position in the marketplace. We sort of sit from an IBD perspective around the fifth player in terms of fees. You can really only measure this on an origination basis, because you can't necessarily see the revenues of some of the other businesses.

But we wouldn't want to deploy so much capital that we tried to compete with JP and BAML in the middle market. We're probably not in a position to deploy so many human resources that we want to try to unseat Goldman as the kind of number 3 fee-earner. They have, I think, a differentiated brand in the marketplace.

But, number 4, 5 or 6 in the fee-pool area, we're very, very comfortable in that space. We have one of the elite origination franchises and we're continuing to invest in it and we'll continue to strengthen that. But where we compete, we want to be one of the top three calls for our corporate clients, but we're not going to compete everywhere. Thank you.

Larry Kantor:

Great. Well, those are good questions. I think we're out of time. I just want to thank Tom.

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