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Morgan Stanley European Financials Conference

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Introduction

Good morning. I'm delighted to be here and want to thank Morgan Stanley for the opportunity to open the conference today.

This Conference brings together many of our largest investors and clients, so it's a great opportunity for me, just over four weeks on from sharing the results of our strategic review, to expand on three key areas:

- First the challenges we face as an industry;
- Second the actions we are taking on costs, the area I see as the new strategic battleground for our industry; and
- Third, the impact of current regulatory trends and our current position.

Since launching our strategy on February 12th, I've met with many investors around the world. I'm pleased to say that their response has consistently been positive but there has rightly been constructive challenge. I hope the additional information I will share today will address some of the key challenges raised and underline the robustness of the commitments we made as part of the strategic review.

Industry challenges

Our industry faces three profound challenges.

- A protracted period of subdued economic growth
- A much tougher regulatory framework; and
- Rising customer and client expectations, driven largely by rapid technological change.

Each of these challenges on their own would be significant but together I am convinced they have reshaped the operating environment for our industry.

Let me start with the economic outlook.

Between 1970 and 2000, average global GDP growth was around 3.5%. From 2000 to 2007, this accelerated to nearer to 5%, before collapsing in 2008 and 2009.

Five years on, there is no sign of a return to pre-crisis levels of growth. The optimism of those who hoped this would be a temporary phase has been shown to be false. The global economy now appears set for a long period of subdued growth. Some economists have referred to it as a "contained depression" - contained only because of fiscal and monetary policies that have only been observed before in the context of a world war.

While these strategies have avoided a global depression, they have created an environment of zero real interest rates and ballooning central bank balance sheets. No one really knows how they will play out over the long-term, apart from the fact that, even once we start to recover, they will take considerable time to unwind.

The forces in the global economy that got us to this point still hold and are unlikely to change for a long time, in particular the recycling of savings in the East through the purchase of Western government debt.

As a result, forward estimates of growth have been consistently downgraded over the past two years as a result. The impact on behaviour can be seen in the health of corporate balance sheets around the world. In this environment, the individually rational decision is to save, not spend.

The global crisis, of course, is also the reason for a very different regulatory framework today.

Much has been said about the financial impact the changes will have on banks, but there has been little detailed focus as yet on the cumulative effect on the way banks will operate in the future.

Prudential reforms are increasing costs through changes to capital, liquidity, funding, risk management and corporate structure. At the same time, conduct and market reforms are reducing historic streams of revenue and prompting changes in the behaviour of customers and clients. The increased focus on judgement within supervisory regimes means these shifts will be both more permanent and yet less predictable.

This is the corporate equivalent of changing the sails in a Force 10 gale.

At the same time customer and client expectations are rising.

I think we all know this subjectively, but let me share some hard numbers to demonstrate it objectively.

- Sales of e-books exceeded sales of printed books last year for the first time, only five years after the launch of the Kindle.
- Over 40% of customers abandon a website if it doesn't load within three seconds.
- A couple of years ago, Facebook did not have a mobile version of their site – today they have close to 600 million mobile users, nearly 60 per cent of their members.

What these figures show is that people today demand to access what they want, whenever they want and on their own terms.

In the corporate and institutional sphere, the same principles apply. We used to talk in terms of "T+1", but that's now become "T+0". Rather than phone a dealer, corporate treasurers now want to access the information necessary to manage their positions at their desk, with real time prices, so that they can deal directly.

Transaction times are also shrinking in the corporate and institutional sphere with many moving entirely to no touch. For example, over 90% of government bond transactions at Barclays were made electronically in 2012.

Together, these three challenges represent a secular shift for our industry. They are permanent and they are material. This, if you like, is the new normal.

Those banks that fail to understand this paradigm shift will fall behind. But for those that can harness the trends to their advantage, there is a real opportunity to build a customer and client focussed, socially useful bank that generates superior and sustainable returns for shareholders.

A unique chance to build what we have called the 'Go-To' bank. That is our goal at Barclays and that is what the Transform plan will deliver.

Commitments

It was against this new normal that we carefully considered both the competitive position and expected performance of the Barclays group, and made a number of commitments to our shareholders as part of the strategic review.

On the financial side, we made six commitments:

- To deliver a return on equity for the Group in excess of the cost of equity by 2015;
- To reduce the cost base by £1.7bn on a net basis over the period to 2015;
- To achieve a cost to income ratio in the mid 50s;
- To reduce RWAs by £75bn gross by 2015;
- To ensure our transitional Common Equity Tier 1 ratio exceeds 10.5% in 2015; and
- To accelerate our progressive dividend policy from 2014, targeting a payout ratio of 30% over time.

We also made two non-financial commitments:

- To embed our purpose and values across Barclays and publish an annual scorecard assessing our performance; and
- To provide greater disclosure and transparency around our financial results and performance, aiming to be industry leading.

Each of these commitments has been carefully considered and reviewed in advance with our regulators. Like you, they asked questions and raised challenges but the dialogue was constructive and supportive.

Each of the commitments is important individually. Collectively, however, they demonstrate how we are going to address the new reality and how we will meet the needs of all our stakeholders.

Strategic cost management

Cost is the critical underpinning of many of these commitments, much more so than income. In the operating environment that I have just described, we cannot look to revenue growth as we did in the past to deliver improved returns for shareholders. That is why I see costs as the key strategic battleground for our industry.

This is a new philosophy for Barclays and is very different to the drivers of our earlier investor targets.

Barclays, like many of its peers across the sector, has up to now largely practiced tactical expense management. You all know what I mean. Hire in the good times and fire in the bad times. A temporary crack down on travel or training. Perhaps even a purge on the supply of proverbial paperclips or biscuits.

I am not saying such an approach was wrong. This is how our industry has operated for decades and it can be successful for short timeframes.

The cost program we announced in 2011 fitted into this approach. We reduced our non-performance cost base by £2bn, but primarily through avoidance and dampening down demand, rather than by driving through permanent structural change.

But, as I have said, our world has changed. Easy growth has disappeared and resources for achieving that growth are all the more precious. The challenge is to improve the productivity of those finite resources – capital, infrastructure, and of course, people.

It's about thinking like an industrial process engineer – something other industries have done for decades, where it is crucial to understand factors like quality, rework, defect, and automation.

In Japan, for example, a leading automotive manufacturer reduced the price per car by 10% and general expenses by 20% while improving quality through simplification and automating manual processes. We are determined to put these lessons into practice.

The way we think about what we have called Strategic Cost Management is not as one dimensional as where to cut and spend less. It is also about where to redeploy resources and, importantly, to spend more.

The process has to start with delivering the right customer and client experience. For if we focus on getting the end to end process right, then it is easier to see where we can eliminate cost through automation, elimination of rework and reduced complaints.

Such a focus ensures we get the balance right with regard to costs, controls and customer or client experience. History, including several recent examples from our industry, has shown what happens when companies get this balance wrong. Cut in the wrong place or too much and the result will be woeful service which reduces revenue and costs more money to sort out.

Or it results in control failure like fraudulent trading or mis-selling, again very costly to sort out and hugely damaging to trust and reputation. Conversely get it right and you can save significant cost.

For Barclays, the opportunity is significant. Those of you that have followed the company for many years will know that Barclays largely operated as a federation of businesses over the past 10 to 15 years.

This was deliberate and understandable given we were in process of building a top-rated investment bank, turning around big businesses like Barclaycard, Absa, and UK Retail, and growing ones organically like Wealth.

Each business had a specific mission and mandate but often worked at arm's length from one another. Though I believe that we were successful on one level, the downside was a build-up of redundant resources and inconsistency, especially in our middle and back office processes.

As a consequence, for example, we have many duplicate functions and areas of the bank that are either drowning in manual spreadsheets or overloaded on paper.

Our strategic cost management program aims to achieve a reduction in the Group's total cost base by £1.7bn from 2012 levels, net of costs to achieve and after investment in areas of high returns.

My objective in setting this target was to be simple and direct, both for our shareholders and for the company.   It's a definition that includes for example – performance costs, non-performance costs and the bank levy. Everything in fact that our shareholders ultimately pay for.

Feedback from investors has been positive and enthusiastic – they like the simplicity of the target and boldness of the quantum.

Behind this broad figure is a great deal of analysis and detailed planning. I want to share some of this thinking with you.

Although we are focused on delivering the £1.7bn net reduction, the actual gross cost savings over this period are much higher. We have identified nearly 90 projects that will drive these savings, ranging from the restructure of the Corporate and Investment Bank front office we have already announced to transforming the Africa branch network in the same way as we did successfully in the UK to smaller programs such as rationalising IT services in our Wealth business. It is a diverse and wide-ranging set of projects that will touch every part of the company.

Across the portfolio, we estimate these projects have an average payback of between 2 and two-and-a-half years. Of the savings I mentioned earlier, approximately half will come from the businesses themselves, primarily in Corporate and Investment Bank and the retail businesses within the UK, Europe, and Africa. The other half will come from across the functions that underpin the businesses, such as technology, finance, and HR for example.

Again, some of these projects have already been announced such as the Corporate and Investment Bank and Europe, and more will follow.

These projects are being run under close scrutiny and governance, as they form a central part of the Transform program. Though our commitments are framed around 2015, we expect to achieve further savings and benefits beyond this planning period as a result of the reductions in the costs of our operating platforms.

Many of the programs are based on substantial use of technology and automation, particularly in areas where we can enable self-service.

Let me quickly cover some of the questions we've been asked.

Yes, I expect there will be substantial reductions in staff numbers over time alongside automation, but we are not targeting a specific headcount number. We announced a reduction of nearly 4,000 FTE last month. There will be further reductions to come in 2014 and 2015, though we expect these will largely be achieved through natural staff turnover.

Some have also asked 'what's different now'. Two things are different.

First, as I have already said, the playing field for financial services has changed dramatically for the foreseeable future as I mentioned earlier.

Second, technology has progressed to a point where it can be better harnessed to deliver results than was the case just 4 or 5 years ago. The widespread use of mobile technology and development of open source architecture are obvious examples of these changes.

Some have also asked me how realistic is it to grow and cut simultaneously, inferring that we can only do one or the other. As I said earlier, this is about balance. We have demonstrated over the past two years that we can reduce cost and grow the business at the same time. I don't see a hard, linear relationship between income and cost.

I would also remind you that Barclays retains significant growth potential across several businesses, which shouldn't be overlooked, such as Africa, Card, and Wealth. This also includes the investment bank, where I expect we will continue to consolidate our leading positions across many asset classes in FICC as well as continue to outpace market growth as we did in 2012 in Equities and IBD.

In the last few weeks, the compensation elements of CRD IV have also given rise to questions. There is still much work to do before we will know the full implications of these regulations and we are working with the authorities on this.

However, we do not expect the changes announced to affect our ability to maintain the appropriate talent to deliver on our commitments.

Regulatory environment

There are, of course, risks to delivering the Transform plan. We see four in particular - a major macroeconomic downturn; a significant unexpected change in regulation; legacy issues; and failure to execute the plan.

To address the first risk, we have been deliberately conservative in our planning. On legacy issues, as you know, we have a number of on-going areas of litigation and regulatory review. These remain subject to varying degrees of uncertainty. While we have put in place robust processes to address them, we will remain vigilant and proactive. Execution risk is completely within our control and it rests squarely with me and my leadership team.

I want to spend a moment on regulation - which has been raised in many of my meetings with investors. I know structural reform remains an area of focus for many of you.

We believe that the direction of travel on the principal reforms is clear now and that they are manageable from the perspective of operating model and earnings.

Our track record demonstrates our ability to adapt to changes while still delivering on our commitments, which gives me confidence despite the residual uncertainty.

I outlined our latest thinking on ring-fencing in the UK in our strategic review. We are confident that the costs of these reforms will be lower than current market estimates and we are already implementing actions that are not dependent on the detailed legislation and regulation that will only come next year.

On Volcker, we expect a final rule this summer. As you know, we do not expect this to have a material impact on our business. We do not operate significant principal trading businesses, and we expect to reduce the remaining activities considerably over time.

On the requirement to establish an Intermediate Holding Company, we recognise what the US authorities are seeking to achieve and have an open and constructive dialogue with them to understand how this rule will be implemented. We expect further guidance in the course of this year and are analysing a number of scenarios and preparing contingencies in anticipation. From what we see so far, we think this too will be manageable for Barclays.

Conclusion

Before I finish I want to give a quick update on current trading.

We said at the time of our full-year results that we had had a good start to 2013 and we continue to see that in Q1. At our Strategic Review presentation, I set out a plan to transform our cost base, financed by a program of restructuring and investment, including £1bn in 2013. We expect to incur about half of that in the first quarter as we have announced a reduction in our European retail branch network and a re-sizing of our equities and investment banking operations, primarily in Asia and Europe.

To conclude, in our Transform strategy, we have a plan which sets a clear course for Barclays in this new climate of subdued economic growth, a much tougher regulatory framework and significantly higher customer and client expectations. An enhanced customer and client experience delivered by strategic cost management is a critical element of our plan.

Our focus now is on putting this strategy into action.

We have a detailed execution plan for all our Transform work streams and for each of our 75 business units. Each work stream and each business unit has a named senior executive accountable to me for delivery.

There is much to do but I am delighted by the determination of everyone at Barclays to build the 'Go-To' bank. I look forward to updating you on our progress in the months ahead.

Thank you very much.