Barclays European Financials Capital Summit

Dan Hodge, Group Treasurer

Confessions of a Capital Geek

My brief on speaking to you today was that anyone attending this conference is probably a bit of a capital geek. As a self-professed capital geek myself, I have therefore deviated from my normal conference script of selling the Barclays credit story to provide some perspectives on how we manage capital at Barclays.

You can see from the slide here that there will be 5 sections to my talk

Firstly – "enough is enough" – how do we determine the right level of capital?

Secondly, "how do we rate?" – this is about how the rating agencies take capital into account in their ratings

The third section is about the capital walk, i.e. how do we manage through headwinds and tailwinds

The fourth section looks at other components of capital besides CET1, i.e. leverage and loss absorbing capital

And I'll end on the upbeat topic of how to allocate surplus capital in the future!

So section 1,on the face of it, capital planning is easy – maintain enough capital to meet future minimum regulatory requirements plus a prudent management buffer.

In practice it is anything but. The regulatory framework has evolved to such a point that minimum requirements are multi-faceted. It's necessary to consider several different lenses and to be prepared to switch between them as the relevant binding constraint.

Defining a prudent management buffer is also complex. Too high and it creates a drag on returns - too low and it results in the risk of breaching regulatory targets with adverse consequences for the firm.

So to help shed some light on the minimum requirements, I am going to talk a bit about the two key components in determining the target capital ratio: management distribution restrictions (or MDRs), and stress testing.

When Barclays issued its, and the UK's, first, AT1 transaction in 2013 the market was not familiar with the concept of MDRs. Since then managing to MDRs has become the cornerstone of regulatory requirements and is now very commonly understood.

Currently, Barclays targets to hold an internal management buffer of 150 to 200bps above the ratio at which MDRs would apply.

That management buffer is partly a function of the structural volatility of the capital ratio to financial variables such as interest rates, FX, and inflation.

These variables impact the large structural positions held by the firm such as investments in foreign subsidiaries, the liquidity buffer and defined benefit pension fund.

While these variables are all risk managed and the portfolio also provides some natural hedge (e.g. between pension and liquidity buffer for example), the bank is inevitably exposed to some residual volatility.

The buffer is also sized to accommodate potential business underperformance and one off items. We are very pro-active in this area, for example setting business level limits for RWA and leverage exposure and running a comprehensive Early Warning Indicator (or EWI) framework. The EWI framework is in turn linked to a suite of management actions we can take in response to a deterioration in our ratio for whatever reason.

A second lens in setting capital levels is stress testing. It is our aim to always remain above the stress hurdles set by the Bank of England and above our own internal hurdles in our own stress tests.

Related to this is the PRA buffer, which is added to the capital stack above the level at which MDRs would be applied.

Whilst the PRA buffer is confidential, as a matter of policy, it is informed by the Bank of England stress test, albeit there is no mechanical link between stress test results and the setting of the PRA buffer. The 2016 Bank of England test was particularly severe, stressing our key markets and geographies simultaneously and resulting in a draw-down of 4.5% from our 2015 year-end balance sheet.

These results informed our decision, combined with our view on the sensitivities just mentioned, to increase our expected end-state management buffer from 100 to 150 basis points range to 150 to 200 basis points range. The top end of this new range would result in a buffer of 4.5% over Bank of England stress test hurdles in end-state, which reflects the 2016 draw-down.

To square MDRs and stress tests, at any point in time one of these perspectives may be more binding than the other. As it happens for Barclays they are broadly equal right now – the upper end of our end state target capital ratio of 12.8% provides a 200bps buffer to MDRs and a buffer consistent with the 2016 Bank of England stress test.

For Barclays, we feel it is appropriate to set our targets primarily in proportion to our own minimum requirements and our own analysis of capital volatility. However an assessment of peer capital ratios is also useful to understand the relative positioning of the bank on capital. I would note that there has been a gradual move up in UK bank peer ratios into the c. 13% range, consistent with our own internal target, and slightly higher than main US and Continental European Peers.

Our key intent here is to balance financial strength with acceptable shareholder returns in the end-state, and is something we think both our debt and equity investors can agree on.

On now to section 2 - besides regulatory bodies, there are other external stakeholders interested in the level of capital a bank holds, a key example being Credit Rating Agencies.

Capital is a key component in assessing the stand-alone creditworthiness of banks - as defined by Fitch's Viability Rating - VR, Moody's Baseline Credit Assessment - BCA, and S&P's Stand-Alone Credit Profile – SACP.

Rating Agencies assess capital based on both quantitative and qualitative factors, including forward-looking capital projections, regulatory requirements, published stress tests, peer analysis and other external considerations. Credit profiles can also be enhanced through the presence of bail-in-able debt and other forms of support.

Given the key role that capital plays in determining ratings, it is important for us to understand the potential rating implications of capital decisions, and factor these into our thinking.

To further expand on this I want to spend a moment on each Rating Agency's approach to capital and look at how Barclays fares:

Fitch assesses capital through its "Capitalisation and Leverage Factor Score", one of four components of the Financial Profile assessment within its VR. In contrast to the other Rating Agencies, Fitch does not attach a numerical weighting to the different components of the VR, but instead takes a 'holistic' approach. For Barclays, Capitalisation and Leverage are deemed to have a "moderate influence" on VR.

The core quantitative metric for capital is 'Fitch Core Capital', expressed as a proportion of regulatory RWAs.

Fitch views Barclay's CET 1 and leverage ratios as appropriate for our risk profile, and broadly in line with the European Global Trading and Universal Banks peer set.

Again in contrast to Moody's and S&P, Fitch does not generally differentiate between HoldCo and OpCo ratings. Barclays' achieves a single-A flat rating for both taking into account Fitch's expectation that our regulatory capitalisation will continue to accrete towards our end-state, as we have articulated.

Turning to Moody's, capital is one of five components of their Financial Profile, which underlines the Baseline Credit Assessment – BCA. Moody's core quantitative metric for capital is "Tangible Common Equity", as a proportion of regulatory RWAs. For Barclays, capital is a relative strength within our Financial Profile and we achieve a "Macro Adjusted" score of "a1" for capital, compared to our overall Financial Profile of "baa2".

Additional quantitative and qualitative factors are then applied to arrive at a final 'Assigned Score' for Capital, which theoretically contributes 25% of the Financial Profile of a bank. For Barclays, whilst Moody's expect regulatory capital to continue strengthening we achieved an 'Assigned score' of 'a2' due to their views on possible ratio volatility

Moody's 'A1' OpCo Senior rating results from notching uplift relative to the baa2 BCA via their LGF Framework as well as government support. The 'Baa2' HoldCo Senior Rating is in line with the BCA of the Group.

Finally in S&P's Framework, 'Capital and Earnings' is one of four categories which drives a bank's SACP. S&P's core quantitative metric for capital is the 'Risk-Adjusted Capital – RAC - ratio and, in contrast to Fitch and Moody's, S&P not only calculates its own capital but also its own RWAs. In addition, S&P's 'Capital & Earnings' assessment is forward-looking and based on each bank's projected RAC over the next two years or so. Additional considerations apply, although the projected RAC ratio is very influential in determining the final capital assessment.

For Barclays, capital is deemed neutral to our SACP with our RAC ratio last assessed towards the top of the 7% to 10% 'Adequate' band. S&P's 'A-' Senior Rating for our OpCo benefits from notching uplift relative to the stand-alone rating from S&P's ALAC Framework, reflecting bail-in-able debt. The BBB flat Senior Rating for our HoldCo is one notch lower than the SACP, which is S&P's standard rating treatment for HoldCos.

So overall, there are a variety of approaches deployed by the Rating Agencies all of which have capital as an input. For Barclays, having an understanding of these approaches provides an important context to our capital planning. But we can't control these approaches – what we can do is continue to deliver on our established track record of building capital – and that is very credit positive.

Moving to section 3 - we convey our strategy and financial strength with reference to end state – but how do we actually get there? For Barclays as many of you know, this has been a long and steep upward sloping journey. Capital planning is all about managing this journey and considering both the smaller movements quarter by quarter as well as positioning for much larger strategic impacts.

I have always said our CET1 trajectory will not be linear on a quarter by quarter basis and that investors should be more focussed on the overall trend. Given we have now moved into the lower end of our end state CET1 target well ahead of schedule, we feel more relaxed about this non-linearity and can be more strategic in deployment of capital in ways that add value – the redemption of three separate series of USD preference shares in the past 12 months is a good example of this.

Going forward there are a number of larger items we need to take into account.

Starting with the positives, there are really 3 main ones - the expected strong capital accretion from the Core business, a further reduction of the Non-Core and the execution of Africa deconsolidation

We are focused on improving the returns from our core business to double digit levels over time. In the full year 2016, we achieved a 9.4% RoTE, a little bit below where we would have liked to be.

But 2016 does illustrate the power of the underlying business – we made £3.8bn of attributable profit excluding notable items, equating to 114bps of CET1 generation from Barclays Core in one year.

As for Non-Core, we've announced the anticipated closure of this unit at end June, when we expect RWAs to be down to about £25 billion. This is a significant reduction from a starting point of £110bn in 2013.

While the updates we can give on the Africa divestiture are limited, we have previously guided to expecting 75 basis points or more ratio accretion. That accretion is struck off a year-end share price and year-end exchange rate

Of course a capital plan has to plan for the headwinds to capital too. In our capital plan we expect to use some of the capital accretive items mentioned above to absorb the impact of one off rule changes such as IFRS 9 and FRTB. However I have become much more optimistic on the likely impact of regulatory change generally and it feels like in the main this will be evolution rather than revolution.

IFRS 9 is the most immediate such impact. Although there is still work to do, I feel we're well prepared, having made a conservative assumption that there is no regulatory transitioning of the CET1 impact in our capital plan. Transitional relief is however looking increasingly likely in practice following recent EBA pronouncements.

On the subject of regulatory rule changes, there is clearly a degree of uncertainty in what the final impacts will be once all the regulatory rules such as the Basel risk weight calibration (or Basel 4 as it is commonly referred) have been agreed and become applicable. However, as we've seen, the delays in the finalisation of the framework highlight that there is still more thinking that needs to be done by regulators and we are vigilant in our forward plans in the meantime.

Before leaving this section, it's important to note we obviously don't just manage a single capital ratio – if only it were that easy! We need to ensure we meet our prudential ratios for all of our individually regulated entities, which will include in the near future the UK ring-fenced bank. All UK banks are still awaiting full details on the minimum requirements of entities operating under the new ring-fencing regime. For Barclays we expect the capital levels for the ring-fenced bank and non-ring-fenced bank (BBPLC) to be broadly similar to that of Barclays Group. In the near future we hope to be able to give further detail on this.

Moving now on to section 4, whilst we focus primarily on CET1, the leverage ratio is still an important requirement that we need to consider. Intended to be a backstop measure to guard against variation in RWA models, it can be still be a binding constraint to some banks where their business models generate low average risk weights.

The UK regulator views the leverage ratio as an important part of prudential regulation and clearly more than just a backstop. Over and above the minimum requirement of 3%, the UK imposes GSIFI leverage buffer requirements (where applicable), and will also apply a countercyclical buffer once the Bank of England determines one is appropriate.

The Bank of England has also introduced an average leverage ratio concept to ensure that firms are not purely managing to externally reported leverage ratios. The Bank of England has also made changes to permit the offsetting of relevant Central Bank exposures which we view as a very sensible adjustment to the international framework that ensures banks are not deterred from holding strong levels of high quality liquid assets due to leverage restrictions.

We are expecting to see further developments in due course; the Bank of the England will publish its review on the leverage ratio later this year and the BIS will eventually finalise their leverage ratio proposals which will then be incorporated into CRR.

For UK banks, as a result of the above, the conventional CRR spot leverage ratio is becoming less important, although we still have yet to find out whether this is relevant for future Bank of England stress test purposes. Going forward we will give much more focus to our UK leverage ratio which was 4.5% at the end of last year. We remain confident on the upward trajectory of the ratio as we continue to accrete capital and remain disciplined on balance sheet usage

One area where we have received welcome clarity of late is MREL. The Bank of England set out a clear set of requirements in November 2016 for quantum and timing, which allows us to better plan for the time period until 2022. This leads to very manageable total and annual issuance requirements for Barclays, with the regulator having included appropriate staging posts to respond to regulatory change and market developments.

We are following closely the evolving debate on instrument eligibility after the publication of draft CRR2 late last year and remain in close touch with the Bank of England. Our general philosophy here however is that we would prefer to respond to the final regulation rather than trying to adapt to draft rules which (as we have seen during CRDIV) can change.

I often get asked about our issuance plans for MREL and other capital securities. As you will be aware, year to date we issued about £6.3bn equivalent of MREL securities including a £1.25bn AT1 transaction so we are happy with the progress we have made so far. We felt it was prudent to de-risk our issuance plan in 2017 and this will allow us to be more opportunistic in the balance of our issuance.

There are also structural reform and intra-group considerations impacting debt capital. For instance, Barclays UK, or RFB, is expected to have a slightly higher level of MREL as no pre-positioning discount is expected to be permitted by the Bank of England. Also at some point we will "switch on" the subordination of MREL downstreamed from our HoldCo. Currently MREL is downstreamed to BBPLC on a senior basis. When the requirements are made clear by the Bank of England, hopefully at some point this year, we will (as flagged) subordinate these internal instruments.

On AT1 generally, you should expect to see us as a programmatic issuer. Our issuance needs will be a function of a number of things, including the Group's Pillar 2 requirements, ratio volatility management and leverage headroom. We think that is appropriate to target a surplus to our minimum end state AT1 requirement of 2.3% to cover for potential volatility and to provide ourselves with flexibility to manage calls as we see fit. Our recent transaction was in GBP and going forward we see USD and GBP as the preferred currencies for AT1 issues as they match best the mix of our RWAs given our transatlantic business model.

As for T2 we are in a comfortable position in terms of the quantum of the current stack which will support the transition away from legacy OpCo instruments and provide some flexibility should opportunities to optimize the capital structure arise.

In terms of our legacy stack, a large part of our subordinated debt matures or comes up for calls before 2022. However, we will always remain alert to liability management initiatives to further optimize the legacy stack.

Lastly, I wanted to finish on a positive note. Given we are now within our target end-state, we can begin to think more about future strategic deployment of capital. To that end, at Barclays we are developing a Group wide capital allocation framework that will ensure that capital is matched to its most productive uses, across products, businesses, and entities. It's great after nearly a decade of building capital and wondering which risks to cut next that we're spending time building these tools. We're even getting lots of investor questions about which businesses we're going to grow, which is both surreal and pleasing after the last decade.

Hopefully this has been a useful tour of how we think about capital and concludes my confession.

Important Notice

The information, statements and opinions contained in this presentation do not constitute a public offer under any applicable legislation, an offer to sell or solicitation of any offer to buy any securities or financial instruments, or any advice or recommendation with respect to such securities or other financial instruments.

Forward-looking Statements

This document contains certain forward-looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934, as amended, and Section 27A of the US Securities Act of 1933, as amended, with respect to the Group. Barclays cautions readers that no forward-looking statement is a guarantee of future performance and that actual results or other financial condition or performance measures could differ materially from those contained in the forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward-looking statements sometimes use words such as 'may', 'will', 'seek', 'continue', 'aim', 'anticipate', 'target', 'projected', 'expect', 'estimate', 'intend', 'plan', 'goal', 'believe', 'achieve' or other words of similar meaning. Examples of forward-looking statements include, among others, statements or guidance regarding the Group's future financial position, income growth, assets, impairment charges, provisions, notable items, business strategy, structural reform, capital, leverage and other regulatory ratios, payment of dividends (including dividend pay-out ratios and expected payment strategies), projected levels of growth in the banking and financial markets, projected costs or savings, original and revised commitments and targets in connection with the strategic cost programme and the Group Strategy Update, rundown of assets and businesses within Barclays Non-Core, sell down of the Group's interest in Barclays Africa Group Limited, estimates of capital expenditures and plans and objectives for future operations, projected employee numbers and other statements that are not historical fact. By their nature, forward-looking statements involve risk and uncertainty because they relate to future events and circumstances. These may be affected by changes in legislation, the development of standards and interpretations under International Financial Reporting Standards, evolving practices with regard to the interpretation and application of accounting and regulatory standards, the outcome of current and future legal proceedings and regulatory investigations, future levels of conduct provisions, future levels of notable items, the policies and actions of governmental and regulatory authorities, geopolitical risks and the impact of competition. In addition, factors including (but not limited to) the following may have an effect: capital, leverage and other regulatory rules (including with regard to the future structure of the Group) applicable to past, current and future periods; UK, US, Africa, Eurozone and global macroeconomic and business conditions; the effects of continued volatility in credit markets; market related risks such as changes in interest rates and foreign exchange rates; effects of changes in valuation of credit market exposures; changes in valuation of issued securities; volatility in capital markets; changes in credit ratings of any entities within the Group or any securities issued by such entities; the potential for one or more countries exiting the Eurozone; the implications of the results of the 23 June 2016 referendum in the United Kingdom and the disruption that may result in the UK and globally from the withdrawal of the United Kingdom from the European Union; the implementation of the strategic cost programme; and the success of future acquisitions, disposals and other strategic transactions. A number of these influences and factors are beyond the Group's control. As a result, the Group's actual future results, dividend payments, and capital and leverage ratios may differ materially from the plans, goals, expectations and guidance set forth in the Group's forward-looking statements. Additional risks and factors which may impact the Group's future financial condition and performance are identified in our filings with the SEC (including, without limitation, our annual report on form 20-F for the fiscal year ended 31 December 2016), which are available on the SEC's website at www.sec.gov.

Subject to our obligations under the applicable laws and regulations of the United Kingdom and the United States in relation to disclosure and ongoing information, we undertake no obligation to update publicly or revise any forward looking statements, whether as a result of new information, future events or otherwise.