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Barclays PLC

Barclays PLC 2015 Interim Results Announcement

Fixed Income Analyst call Q&A transcript (amended in places to improve readability only)

Robert Smalley

A couple of questions around TLAC and some of the structural issues that you talked about. In terms of issuing out of the holding company and then downstreaming like-for-like to the operating companies, once that no longer becomes like-for-like, as it would be done on a subordinated basis, is there a reporting requirement for that?

I know you've talked about it at the back of these slides, but as you're doing the issuance, would there be a reporting requirement for that? The reason is because of the implication for the entire senior holding company asset class once that first issuance occurs.

Steven Penketh

Yes there is. If you look at the proposals under the recent TLAC term sheet, they make it clear that transparency around TLAC flows on a group basis is a requirement. What we have done, as you will see from slide 17, is actually start that requirement early, in the sense that it doesn't actually need to be in place until 2019, I think, under current proposals.

But our view was because we were issuing term debt beyond, for example, ring-fencing periods and all those different types of things, it was better to be front-footed about this. So, we've actually started to give full disclosure about the investments made by our holding company in our subsidiaries, which obviously at the moment is just Barclays Bank PLC, but it's something which we would intend to do on a running basis through our normal market disclosures. So, it should be a requirement, and I'm sure that others will follow through.

Robert Smalley

But will you be making that disclosure upon issuance of the securities?

Steven Penketh

We will give the disclosure on a quarterly basis at the moment. I think we did it last quarter, we've done it this quarter, and we will do it through all our IMSs, so if there's anything material that changes on an intra-period basis, obviously you'd be subject to our IMS requirements, but our anticipation is it would just be a quarterly disclosure, which will keep you up to date with the internal capital flows upon inflation.

Robert Smalley

Thanks. Has there been any discussion about bringing TLAC forward in any kind of transitional basis? In other words, instead of making 1st January 2019 the beginning date, that some of the requirements may be phased in, in a year or two before that?

Steven Penketh

No, there hasn't, as far as we're aware. I think the term sheet actually uses 1st January 2019 as the earliest date for conformance. So our expectation is that that would hold.

Robert Smalley

If I could just ask another couple of quick ones. In terms of some of the old T1s that you have, legacy T1s, there are some at the bank, some at the holding companies. The ones at the bank, can they be migrated to the holding company in some way, or would they be migrated to the ring-fenced bank?

Steven Penketh

The important thing to remember around migration of liabilities is that it's a purely consensual basis, and so in order to have that migration happen, you've got to enter into a formal novation. So, if there was anything that would ever be done with regards to migration, looking at what banks have done historically as well is part of a general consensual liability management exercise which engages with the market.

We obviously have no current intentions with respect to that, because the TLAC term sheet could actually make clear that capital loan funding, if it was CRR-compliant and actually out of the operating company, you could count towards TLAC, but I think the important aspect is going forward, when you look at the issuance and the refinancing we're going to do, that'd be coming out of the HoldCo.

Robert Smalley

Okay, and then one last one. I know in the call this morning, there was a lot of discussion around increasing dividend payout ratios. Now you've got a different audience on the call. How are fixed-income investors supposed to look at that? How will you balance the needs of the fixed-income community versus those in the equity community now that you're setting yourselves up for, number one, a bigger dividend payout, and number two, a possibility of taking down the management buffer a little bit, as you had mentioned a little earlier?

Tushar Morzaria

I'm not sure it's correct to say that we'd have a larger payout ratio. The change in the dividend policy that we announced this morning, first and foremost the board expects to keep the dividends flat for this year at 6.5p. Consensus for our dividends was slightly higher than that, so perhaps from a fixed-income perspective, that's probably good news.

In terms of where the dividend goes from perhaps next year onwards, previously our policy was quite formulaic. It referenced a payout ratio referencing adjusted earnings per share, targeting a range of between 40% and 50%. We've decided that it's no longer appropriate to be just having a mechanical payout formula but to grow our dividends over time off the back of sustainable, repeatable earnings.

Now, that should be more beneficial to both equity holders and fixed-income investors as well, because the board will take into account everybody, the right thing to do, across the full capital structure, rather than be beholden to a more mechanical, formulaic policy. Dan, do you want to add anything more to that?

Dan Hodge

Yes, I just want to mention our management buffer. We're certainly not reducing that either. You'll assume that our expectations will change a bit from last time we did this call, where we were quoting a range from 100 to 150bpsbps, and now we're actually saying around 150bps.

If anything, we've gone the other way, and as I said on the talk earlier, the scale of the management buffer is incredibly important to us. We certainly don't want to risk dropping into the mandatory distribution requirements, knowing that's something which is very much an interest to fixed income investors, and equity investors alike for that matter. That's something we will continue to assess on a frequent basis.

Tushar Morzaria

And I'd probably add that it's in the board and management's interest to avoid that as well, so I think our interests are all aligned in that one.

Paul Fenner, Société Générale

I've got two quick questions. First on issuance. I know you mentioned both AT1 and T2 in particular. Can you give us a sense of what we might be able to expect out of Barclays for the remainder of the year?

And the second question is on slide 12 on the ring-fencing arrangements, I know it's not something that you want to talk too much about, but just to give us a sense and just to be clear on my understanding. So, the ring-fenced bank is going to be essentially a removal of the retail bank and the ring-fenced operations from Barclays Bank PLC, which is going to leave Barclays Bank PLC much smaller, the legal entity much smaller, and essentially a wholesale bank with the investment bank and some corporate activities with a whole bunch of subsidiaries. Is that right, and how is it that you think you're going to ensure that the ratings and the credit quality is essentially going to remain the same?

Steven Penketh

I think we gave guidance at the first fixed-income call this year that we'd do between £10bn to £15bn, which is an empirical run rate we've had historically roughly on issuance, and that was in the various formats of secured funding, unsecured funding, both private and public MTNs, looking at the different liability stacks as well AT1s, T2 and senior unsecured term debt.

We've done £6bn so far, so that £10bn to £15bn range is obviously quite a large one. Frankly we don't force the market, we never have forced the market, and we aren't actually in any rush to get a certain quantum done. We have plenty of time within which to hit our relevant targets from the capital stack perspective, and then also from the senior unsecured financing perspective.

We'll just watch the market and see how close we get to that £10bn to £15bn range by the end of the year. It is right to say that we have certainly AT1 to do. It is four years to get to 2% of RWAs but, again, that's over a four-year horizon that we've given ourselves, so there is no hurry. One way or another on the different liability classes, we'll just have dialogue with the market to work out where best execution is.

Dan Hodge

On the structural reform question, this is an important issue for us. We're designing both the non-ring-fenced bank and the ring-fenced bank to try and ensure that they're equally as attractive and sound proposition that have strong credit ratings in line with peers. We go through each of the rating agency criteria meticulously to ensure that we get a strong rating. We look at capital strength, credit quality, asset liquidity, and returns.

In terms of the business mix points that you allude to, actually the non-ring-fenced group, which you rightly say would be BB PLC and a number of subsidiaries, is going to be very internationally diversified, and it is a lot more than an investment bank with a bit of corporate activity.

Interestingly enough, in BB PLC, we anticipate less than 50% of the capital being allocated towards the investment bank, and that's not saying that we're taking any capital away from the IB at the moment that's projecting our current strategy forward.

We do have a lot of corporate activity on the non-ring-fenced bank. There's international wealth as well as some international retail products, so hopefully that gives a sense of balance to the design that we're really aiming to achieve there.

Lee Street, Citigroup

Just some questions about the internal management buffer. You mentioned Barclays' recovery plan actions are calibrated to take effect ahead of breaching the combined buffer. Just trying to see if you could give us a sense of what these actions are, how quickly you think they can be undertaken, and what the potential capital benefit of them might actually be.

Secondly, you stated earlier about the management buffer, that it actually has gone up from a 100bps to 150bps range now to being around 150bps. Should we take that as a commitment that that will stay at 150bps, or could you foresee a scenario in the future where that could be reduced, as we've seen happen at some other banks?

And finally, can you give us a sense of how much HoldCo issuance that you think you might need to do to get a notch of LGF benefit at Moody's, because their methodology is not always the easiest to actually cut through?

Dan Hodge

Okay. So, let me take the first two, and then Steve will address the third of those. In terms of the management actions that we will take to avoid going near the mandatory distribution restrictions, I'm not going to quantify these, because, as you'll appreciate, depending on how many of these actions you do, it can have a range of capital outcomes.

But to give us the flavour of what they are, we'll obviously have to look at the proportion of variable compensation, we look at the scale of the dividends and we can look at moderating business growth. We could look at business closures as well. That may be, for instance, accelerating non-core where to do so would be net capital-generative. You might consider a capital raise, but that's at the more extreme end of those particular actions.

In answer to your second question, on whether the guidance to stay at 150 bps above MDAs in 2019, it's not a commitment. It's our current expectations as to where we may end up when we come to 2019. Right now, the buffer is materially in excess of that, it's more like 4% or £15bn to £16bn, and as I said in the talk earlier, we recalibrate that buffer on a fairly regular basis.

We need to make sure that a mixture of BAU volatility and certain adverse events don't cause any likelihood that we would drop into the distribution restriction zone, even with the various recovery actions we could take, and so you should expect that number to be a fluid number.

Our thoughts are that if you look at the regulatory target at the moment at 10.6%, if you add on the 150 bps, it gets you just over 12%. That's our next milestone, if you like. I wouldn't say it's a firm commitment or target. Our next milestone we would like to get to is over 12% from where we are today at 11.1%, and we'll then see where we go from there.

There is another three and a half years until the end state, so that's a long time away, and so I wouldn't definitely say the buffer is going to go higher or stay the same. It could go lower if there is material de-risking, but it's just something we've got to calibrate frequently.

Tushar Morzaria

I think I'll just add to that about stress testing, before Steven talks a bit more about the LGF and about issuance that may be needed to get an upgrade. I think stress testing will evolve between now and then as well. With the PRA, we're running a very comprehensive stress test for the second year running, and if that evolves, I think that will feature more into our thinking of what the appropriate capital level will be.

So I think Dan is absolutely right. It's something we'll keep under review and keep informing the market of what our latest thinking is, and we'll do that as frequently as our view evolves.

Steven Penketh

With regards to the LGF, I think given that the decision is ultimately in the hands of a third party that we don't control, it's not something that we'd speculate on with a huge degree of precision, but I would make a couple of comments around that.

Obviously, at the moment with our like-for-like downstreaming between the OpCo and the HoldCo, we get the four notch differential that Moody's, for example, have given us, who are running the LGF model; they have been a little bit disingenuous with the credit profile as it sits today.

Now, I think that their assessment was actually based on the fact that there was actually no additional raising of funding at the holding companies throughout the projected timeline that they were envisaging. Now, we are refinancing out of the HoldCo as we go.

Our expectation is, as you would see, if you were going to get to a 25% TLAC number, for example, by 2019, you would at that point have actually raised £22bn of additional funding out of the HoldCo, which is a very manageable run rate on a per annum basis between now and then, certainly looking at our historical issuance profile.

Do we think that that would actually give us an increasing or a positive impact on the rating side of the holding company over time? We would like to think so. So, I'm sure that there is LGF benefit there as we make that HoldCo migration, but the precise timing within which it actually is delivered is not for us to determine.

Greg Case, Morgan Stanley

Just a couple of questions from me. Can I just quickly pick up Paul's point first around ring-fencing? So with guys going over to Barclays Bank PLC or staying with Barclays PLC; if you're a legacy OpCo bondholder, I assume you're going to do that via a FSMA part seven scheme. Do you envisage any issues with bondholders registering their discontent in the court on that one?

And then the second question is just around your comments earlier on your senior HoldCo spreads. I was wondering if you were thinking about doing any more T2 issuance over and above what you might have normally wanted to do to benefit that HoldCo spread in the seniors.

Dan Hodge

Yes you're right, it would be a part seven FSMA statutory transfer from listed entities mainly BB PLC to the new ring-fenced bank and obviously that's the liabilities that we would move to the ring-fenced bank so we wouldn't be contemplating a novation on the lines that was discussed earlier of senior wholesale debt to the ring-fenced bank. We're really talking mainly here about insured deposits and smaller corporate deposits.

So that part seven transfer doesn't require creditor consent. Depositors can object though and be heard in court. I think the key for debt investors is what I said earlier, showing a robustness of both the ring-fenced bank and the non-ring-fenced bank which includes BB PLC to make sure they're both very attractive propositions and that's why we're working incredibly hard on making sure these are not only viable entities but they're an incredibly strong and attractive entity and that you won't therefore be prejudiced as a bondholder in BB PLC because there will still be some bonds left in BB PLC, as I said earlier, when the ring-fence is established, notwithstanding that most of our debt by that stage will be at the holding company.

Steven Penketh

Yes, with regard to OpCo and HoldCo differentials, if you look across the different liability sets currently you see roughly HoldCo/OpCo on senior for EUR and USD to be roughly, I think it's about 35-40bps; 35bps in the US and probably 35-40bps closer in EUR for similar maturities.

I don't think that we're actually of the view that OpCo/HoldCo spreads and senior debt should necessarily be on top of each other because there is the ability to downstream on a subordinate basis and certainly with TLAC rules being out there is an observation being made that it is likely to happen in the end stage.

However I do think that that probably exaggerates the risk for the HoldCo and the OpCo today. What is the right number? It's difficult to say and I think when we did our first HoldCo senior debt issuance it was about 15bps as a HoldCo premium, which seemed right to us and given the mitigation strategy we had in place we think that's probably a fair reflection of the structural subordination risk when you consider you've got CET1 generation over the next four or five years potentially, you've got the AT1 issuance, you've got T2 issuance and you haven't yet determined precisely how much subordination for the senior unsecured debt would actually be required and how much we'd actually hold in reg cap instead because that's again an efficiency dialogue with the market.

With regard to the subordinated debt, the only one we have at HoldCo and OpCo is USD and there's actually a delta of about four years, I think, on duration between those two T2 bonds. Currently that's about 60bps wider. If you adjust that for curve and say, I don't know, 20bps is about correct or about 40bps wider for the holding company, given what's been said about T2 debt and the application of losses to operating company subordinated debt as well, we think that probably is very rich.

The expectation is you would expect that subordinated debt to really price pretty much on top of each other but obviously the market is the market and all we can do is just disclose what it is that we're doing and show that we've mitigated the risks and see whether the price settles over time.

Greg Case

Does that make you more inclined, maybe, to do a bit more T2 than you might have done previously? Do you think doing more T2 might be a benefit there for the seniors?

Steven Penketh

We've always said and I think Dan mentioned it in his script, that there is a definite sweet spot to be found in your end state capital stack between the amount of T2 debt that you hold versus the amount of senior you use for potential downstreaming on a subordinated basis.

Obviously given the size and the quantum of those prospective stacks a 5bps move in senior unsecured debt is more painful than a 10bps move in T2 spreads so that's something which we will watch very carefully over the course of the next four or five years as we refinance towards our end state.

Greg Case

Okay, great, thanks and then if you don't mind, can I just ask one more question on capital? I know you're saying that CET1 will stay broadly flat at 11% for the remainder of the year on near-term RWA headwinds. You might have covered this this morning but could you just quickly run through where those will be coming through in terms of if they're divisional or if they're central items and are these trading risk or is it operational risk; where is it coming from?

Tushar Morzaria

Yes, why don't I touch on that, and Dan may want to add more. We've accreted a lot of capital over the last couple of years, it's about a couple of hundred bps of capital, after absorbing a whole bunch of below-the-line items, which probably equates to close to 100bps so we've generated an awful lot of accretion to the ratio.

There are some headwinds that we were anticipating experiencing this year. This is more regular items and I'm not referring to standardised credit risk-weights or fundamental review of the trading book or mortgage floors or anything like that. I think those are more in the area of 2016, more like 2017-type timeframe.

The more near-term pressures are more just regular model changes that we are anticipating in Q3 and Q4. Operational risk RWAs we would expect to rise at some point. It won't happen in Q3. It may happen in Q4 but we'll try and give the market as much advance notice as we can for that and I'll probably do that through the course of the earnings call.

The other thing is the headwinds that we mentioned before, the sort of close to 100 bps of litigation, conduct, below-the-line items; we're trying to work through the caseload that we still have outstanding. It's not a forecast and not a prediction but as we work through that there may be further charges that we wish to provide for and that may or not be a headwind over the course of the remainder of this year.

So I think when you put that all together – and of course we've got a bank levy in the fourth quarter so it tends to be probably our weakest quarter of capital generations for the bank.

And when you put all that together I think it's appropriate to guide to around 11% for the remainder of this year but I think, as Dan mentioned earlier in the call, probably the next objective for us is to get to 12% and we'll do that over time. Any more you want to add to that, Dan?

Dan Hodge

We've performed very well in terms of the run-downs of the non-core but the other thing I would say is the rate of reduction of non-core RWAs has been outstripping the reinvestment in core RWAs and that's not necessarily always going to be the case every quarter so that's another reason why we're not announcing another 50bps rise over H2. It's just another fact to consider in addition to all the others that Tushar mentioned.

Aditya Bhagat, HSBC

Just a follow-up question on senior HoldCo in your responses to both Lee and Greg. Just thinking about it on this being your main funding instrument, and I know you still see this as expensive to issue and you see that upgrades should happen with supply over the next few years, but is there something – and if so what is that – that you would be thinking of doing to help boost the ratings and therefore hopefully the cost of issuing the debt more in the short to medium term?

Steven Penketh

I don't think there's anything that can be done technically by issuance so on the liability side senior debt owners then are significantly increasing capital issuance in order to support it. Now, that isn't necessarily the most efficient cost of capital use for the bank.

But on the asset side you've got underlying improvements to the stand-alone rating for the bank, potentially, as you improve the asset side of the balance sheet and make sure you get it through various structural reform initiatives and other things as well. As Dan said, we're planning very carefully on robust ratings outcomes for all of the underlying subsidiaries. Then there is potential uplift that can come to the ratings from that perspective. Dan, do you want to add anything?

Dan Hodge

Yes, absolutely, if you look at the various subcomponents of the ratings criteria – and I mentioned them in passing earlier – I think the key ones are capital strength, credit quality, asset liquidity and returns. If you look at what we're doing around each of those we made excellent progress over the last two or three years. Capital strength clearly increased to 11.1%. We're going to build that further and credit quality you've been on the call earlier and Tushar was just talking about our loss rates which were in a good, healthy shape there.

As for liquidity, you can see the large surpluses we have to our regulatory requirements, and we are well ahead of them before being minimum requirements. Clearly you've heard the chairman as well talk about what we're trying to do to accelerate increases in our returns. So all of these will have a positive impact on the stand-alone credit rating, which is the baseline rating which drives the other components of the methodology, such as LGF and ALAC, and so the baseline rating is very important.

James Hyde, Pramerica

I'm afraid I have to go back to the ring-fence and what Dan and Steven have been saying. I find it slightly disingenuous to see any way that the two entities can be anything like each other in asset quality, unless I'm missing a trick. I mean, I just don't see mix in credit quality and I don't see a mix of African banking and investment bank and reducing other developed world banking being in any way close to what will be in the ring-fence.

So I'm wondering, has there been a change from the first time two years ago, at the investor day, I think, at the end of June when there was a wider ring-fence first came to the fore, are we now looking at a different cut-off for SME deposits or businesses in the UK to go into ring-fencing? It looks like, from your chart, that even the cash cow part of Barclaycard (the UK) has to go in the ring-fence. I know that you can't say that much about it but can you just give some pointers on how you can make water into wine and make Barclays Bank non-ring-fenced opco anything like a concomitant credit?

Dan Hodge

We've got a slightly more positive view as to what the non-ring-fenced bank is going to look like. We appreciate your concerns. I suppose the other assets I would call out as being part of a non-ring-fenced group that won't be going into the ring-fenced bank would be a lot of the larger corporate loans and the medium corporate loans and it's got some very large balances. If you look at the disclosures we give around the corporate balance sheet size it's pretty material and also it's very high in terms of the credit quality and also drives very, very strong returns.

Also we've got the US cards business that's excluded from the ring-fenced bank because it's going to be part of our US intermediate holding company group, which I would say is actually a very strong diversified business as well.

And the point around cards; US cards will be outside the ring-fenced bank. In terms of where UK cards can go there's some optionality around that. This is one of the things that we're still discussing with our regulators and we'll revert with more detail as those discussions develop.

But I appreciate that you'd like to see more information and more specificity around what goes where and we would absolutely like to share that at a convenient time as well and rest assured, when we do hopefully you'll be a lot more satisfied and convinced of the creditworthiness and the strength of BB PLC and its subsidiaries. So we're doing a great deal of work on this. We've been doing lots of shadow rating work, speaking with agencies and it's a very, very important part of our planning.

James Hyde

Thank you for that, and very quickly, it looks like we might be legacy bondholders on senior and sub at the OpCo which is why I'm asking this question. At some point we might get rising rates; is it possible that LMEs look more attractive or is that in your planning? Because especially at sub debt most of the OpCo sub debt maturities are beyond five years; beyond the cut-off for the ring-fence. Is that something you see as a possibility to get you out of this position where there's just too much trapped debt in the OpCo, in the non-ring-fenced OpCo?

Steven Penketh

I think what I would say to that is if you look at the maturity profile we have and the senior unsecured debt slide and the structured note maturity profile as well which is altogether just senior unsecured debt as an amorphous whole, then by the time you actually get out to 2019 and beyond, you do actually have a maturity of the vast majority of the senior unsecured funding. Now, that will be refinanced. At the holding company – Dan's already made the point in the past that the holding company will always remain, irrespective of the different avenues to structural reform. the ultimate diversification point for debt holders, and so it should be the best place to be and a no regrets place to be from our perspective.

I think that when you look at capital, obviously that is longer-dated. The point here is that the TLAC term sheets made it clear that capital sitting outside an operating company, if it's CRD IV compliant, should also comply with TLAC as well at the same time so there's no urgency around doing liability management exercises for the purposes of cleaning that capital stack to get it up to the holding company.

Having said that, LME is always something that we monitor on a running basis. We've been doing that for many years, we've certainly done large exercises in the past. LME, when it's done properly, should actually be a virtuous circle; it should actually be providing liquidity for end investors, also potential benefit to the issuer at the same time and when the conditions are right that will be something we will consider in dialogue with the markets.

At the moment there is nothing on the table as we currently sit and look at the debt stack but certainly going forward we'll continue to watch that space, as you would always expect us to do.

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