Tushar Morzaria, Group Finance Director

Thanks for joining us again today.

For those of you that have been attending these for a while, you're probably getting into the rhythm of the four or five things I call out every time we get together, and these are the priorities we've set for ourselves for the last couple of years or so now. And hopefully we're getting to the end of this list and we'll have an evolved set of priorities as we go further into the year. But let's stick with what we have at the moment.

First and foremost, I'll talk about Core returns. It's really important that we continue to grow profits in our Core business to continue to generate a double digit return, because obviously the capital allocated to our Core business has been increasing as we've reduced the size of our Non-Core unit. And in full year 2016 we printed a 9.4% RoTE, a little bit below where we would like to be, although we actually feel okay with that. It did have above the line charges; the comp adjustment that we put through, and we're in peak phase – late 2016 and through 2017 – of our ringfencing costs. So I think with that in mind, to grow our pre-tax profit by 4% and get to a 9.4% return on allocated tangible equity when our allocated equity went up by more than 10%, we feel actually okay with it.

The other thing that's very important, and I'd just refer you back to our slide where we showed our quarterly returns in our Core business going back, to the beginning of 2014 I think. And that slide was just to show that our Core returns have been quite stable at around 10% or so in virtually every quarter, just looking through things like seasonality, bank levy and what have you. And the reason why that's important is, of course, we're getting to a point where that should be the Barclays Group. It's always been very important for us to consistently get to that level of return with a very stable trajectory, and I think that historical graph hopefully gives you some measure of how we've done across that. And, of course, to do that, profits have had to increase at a relatively constant basis as capital has increased.

So that's priority number one: Core returns in double digits.

Priority number two is to shrink Non-Core, and we're getting to the point where we'll be speaking less and less about Non-Core, hopefully by the time we get to the second half of the year. We have announced the closure, or the anticipated closure, of our Non-Core unit at around the mid-year. We expect risk weighted assets to be about £25 billion.

To help you with the modelling, we've guided to a loss before tax of approximately about £1 billion, roughly half in negative income, roughly half in negative costs, probably more frontloaded, so the shape of it will be more H1 than H2. But we don't want to be any more specific, because you do start making it difficult for the Non-Core team if you box them into spending a certain amount of budget per quarter. It obviously means that the counterparties that you're dealing with can use that information against us. But hopefully that helps you with what to expect over the course of this year.
Beyond this year, the Non-Core unit – even though it won't be as obvious to you - will continue to reduce on both the income side, the cost side and of course the risk weighted assets and leverage side. And it should be just a steady march down and down. It will be somewhat less obvious to you, but will be a tailwind in the businesses that work out those assets over time. We'll talk more about it at the half year as to what's going where. We won't say that quite yet, but the portfolio left will be mostly our long-dated sterling loans, our ESHLA portfolio as we call it, our back book of derivatives and a portfolio of Italian mortgages, so it will be somewhat obvious where they'll end up I think.

The third one of our priorities was capital. We've been on a steady march upwards to increase our capital ratio and that continues. We're pleased with last year's performance, a net 100 basis point increase in our CET1 ratio, continuing approximately similar increases year on year in previous years.

Of course the other thing, very relevant to capital, is our Africa divestiture. We guided to expecting 75 basis points or more ratio accretion as and when we deconsolidate our Africa investment, and I can talk a bit more about the process of doing that if people are interested in it. That >75 basis points is really just the arithmetic; it's pretty straightforward. It's struck off a year-end share price, year-end exchange rate, assuming no premium, assuming no discount, and assuming full RWA deconsolidation. You can do the arithmetic as well as I can. So depending on what share price and exchange rate you put in, you'll get a different capital outcome. But you'll also know, for those who have played around with this, the most sensitive aspect of the capital ratio accretion is actually the deconsolidation of risk weighted assets rather than the price itself. Obviously the price does have a degree of sensitivity, but the real juice in the transaction is actually the deconsolidation of risk weighted assets.

We did have some questions regarding capital, our pensions as well, and I'm sure that may come up in some of the Q&A. But just to make some comments on this upfront, there's a few things going on in pensions. There's the accounting surplus/deficit which you folks will be very familiar with, which will go up and down by the quarter depending on, it's essentially like a marked to market type computation, which I think you guys are most familiar with.

The actuarial triennial valuation was last done at 2013, circa September 2013. Obviously fast-forward three years, September 2016, is the point at which we've started the next triennial, which we expect to conclude in 2017. As part of the last triennial, we agreed with the pension fund trustees a series of deficit reduction contributions, DRCs as we call them, and that's disclosed in our Annual Report, and many of you have picked that up.

In there you'll have seen that in 2017, this year, we're due to make total payments of £1.25 billion sterling, and the capital effect of that, we've just assumed that capital deduction in our plans. Of course if you're already in an accounting deficit it is already pre-funded, that deduction, if you like. And there are subsequent payments, you'll see, from our Annual Report, what the future DRCs are. Those DRCs will get re-struck as part of this triennial that we'll conclude over the course of this year, and there'll be a new sequence of payments that we'll agree with the trustee. I've given you a little trade secret there that the pension fund is likely to be in a funding deficit, but I suspect that's not something that's shocking to any of you.

We have a very good relationship with the trustees and, of course, when we're doing our capital forecasting it's me who's sitting across the table to the trustees negotiating the funding contributions. So when we're putting together our capital forecast, of course I have the inside track of what I should expect coming out of those negotiations and that will be market-disclosable event once it's concluded. So you can look out for that over the course of the year. We've taken a very prudent approach of what we expect that to be and factored that into our capital forecast and feel pretty comfortable about getting to our end-state capital in good time.

Of course beyond that it is still cash that we're paying out of our capital base into the pension fund and I know there's a question about what does that mean for the longer term distribution. It's a much harder
question to answer for a couple of reasons. One is, if you've noticed historically the shape of the contributions, the DRCs tend to be quite back-loaded. We have a very good relationship with the trustee, and I don't think this is actually in law, but most trustees and the regulator look at a ten year recovery plan, and you can see that the payments tend to be more to the back end of that. And that's really the pension fund trustee being very sensitive to when we're in capital build mode to allow the company to do that so its covenant remains strong and we continue to be a very strong sponsor, and that's a very good relationship we have with them.

The other thing of course is there'll be other triennials. So we may well agree a series of ten year payments, we will agree a series of ten year payments as part of this triennial, but as soon as you get to year four, you'll have done another triennial. So you'll get a new set of facts and circumstances and probably a new schedule of payments. So it's a rolling thing and that's why it's a little bit harder to know what it will be like when you get into the 2020s. Even though we'll agree a series of payments now, it may be different by the time you get there. And of course that'll be driven by what the size of the deficit or indeed surplus may be at that time. So there's plenty for the variables when it comes to long-term forecasting.

But I think the thing for you to really be aware of is that we are in triennial discussions, and we have a pretty good sense of what we think we will agree with the trustees. That is factored into our capital forecasts. We feel very good about hitting our end-state targets with those payments scheduled in. And in the more longer term, three years and beyond, there are several variables that will drive what actually happens at the next triennial, a different funding position etc. I'll take further questions on that if there's any other interest. But that's capital.

The fourth one for me is cost efficiency. You know that we're moving away from explicit cost targets and going more towards a cost to income ratio, targeting to run the Group at 60% or below. We were reasonably close to that in our Core business [in 2016]. Of course that's not representative of the Group, but the Core was at 61%. And actually if you back out the compensation charge that we put through, it would have been below 60% for 2016.

Regarding the compensation [change], it's worth just reminding people that there is actually a multi year effect of this. As we still roll historical deferrals off the old way of doing it, which was pushing them all out so they got accounted for in subsequent years, and under the new way of doing it where we account for it more in year – we'll have a double-dip effect in both 2016 and in 2017; about a couple of hundred million in 2017, so just something to be aware of.

The other thing that's really important for us as part of SRP [Structural Reform Programme] – it's something we don't really talk about - we talk a lot about the ringfence bank and non-ringfenced bank – is the creation of a service company; a single service company that will now service the entire Group. It has the positive that we think over time that will actually be a very efficient model. We'll be able to share a lot of things across our international and UK operations, things like fraud detection, collections, contact centres, all sorts of things like that which will make us a much more efficient organisation. But of course there's a lot of build work going on behind the scenes to reorganise around that.

And that goes into a theme where I think, as a company, we're very keen to create the capacity to reinvest for the future. We've been on a dramatic march down in parts. You can see here we've put a slide of 2013 absolute costs going down to 2016. You can see it was a very meaningful reduction in absolute costs. So I think we've got good credentials in terms of being able to take out costs. But we're looking to also start to recycle some of the capacity back into longer term investment into the Core operations of the company and also back into product services and revenue opportunities as well. But with all of that we will still absolutely target a 60% or below cost to income ratio, but just to give you that flavour of what's going on behind the scenes.

And the final point for me is legacy items; trying to put the past behind us. There's not much I'll be able to say on that, as you can expect. I say this most times, refer to our disclosures in our Annual Report for
the detailed notes on conduct and litigation items. But we’ll hopefully get some clarity with the FCA with regards to PPI timelines, hopefully soon. We’re still waiting for that, but that’s probably the only one I can really comment on and even that will be quite speculative. To be honest, all the other cases, I probably won’t be able to say too much.

So just to wrap up; Core returns in double digits, shrinking Non-Core, keep on increasing our capital base, hit our efficiency targets, and put the past behind us. Those have been our five priorities for some time and will continue to be for a few more quarters, and then we’ll evolve them away into something more forward-looking.

So I’ll stop there and let’s go into our Q&A.

Chris Manners, Morgan Stanley

Good morning, Tushar. Two questions if I may, the first one was on impairment charges; obviously you missed expectation in the fourth quarter. I know that you moved to the higher risk, higher risk-adjusted margin business in the US. Maybe if you could give us a little bit of a flavour for what we should be expecting in the US, and also in the UK if we have an economic slowdown?

The second question I had was; I think Jes mentioned that you’re actually interested in expanding your European equities business in the IB when we had the results last week. And it seemed to me that quite a lot of companies find it difficult to make money there, so can I maybe just ask for a little bit more colour on why you think that’s a good place to allocate capital, especially given the returns on the ring-fenced bank? Thanks.

Tushar Morzaria

On impairment, yes, it’s a tale of two cities really in some ways, the US and UK. I’ll take the UK first and I’ll come onto the US. In the UK, as you’ve seen, impairments continue to trend quite low; delinquencies are actually lower in the fourth quarter versus third quarter. I think it continues to surprise many of us that it still seems to be trending downwards. When we look at other forms of credit indicators within the company, there's nothing overt that would suggest there's any stress in small business, consumer, mortgage, or what have you. We do a lot of also confidence type surveys internally with our customer base. I'd say they're probably not as robust as the spend data or the delinquency data would suggest. So there's an interesting thing that we're very mindful of; if confidence levels and spending patterns and borrowing patterns continue to not correlate with each other, that's something we'll be very cautious with.

In the UK, having said that, we haven't really changed our risk appetite at all really since the time of the last crisis. So we haven't really moved around the risk spectrum at all in the UK. Regarding mortgages, new production is still in the high 60s (% LTV).

One thing we have probably done is pared back from super long-dated zero balance transfer market in our card business. That's a very deliberate decision – we're finding it harder and harder to make the numbers work. You'll see us pulse in and out of that market. There is an advantage of actually still being the most favoured product there because you get first look at all applications. When you're further down, you get other refusals, if you like, and so you get some adverse selection if you're not careful. So you'll see us pulse in and out, but we're really not looking to attract and grow much balances there, and are trying to keep that book running off a different product basis.

In the US it's a little bit different in the sense that the sector has had an increase in delinquencies. Now, it's pretty small numbers and a pretty small increment off very small numbers. So noticeable in the sense that pretty much every US bank that reported had it, but really still very low levels. If you were just looking in absolute terms, you’d think, gosh, that's so low.
For us, we were a little bit more than the US market. I think the majority of the US market movement is as much explained, I suspect, by card seasoning as it is by a genuine change in consumer behaviour. The credit card market in the US has been growing steadily and probably took off, in terms of a little bit of acceleration, probably in 2013, 2014, 2015. And the way these portfolios tend to mature, the seasoning effect, you tend to get a slight uptick in impairments two/three years into the maturity of those portfolios. So we've seen a bit of that. Of course we had a lot of new partnerships that came online around that time that have been very profitable.

The other thing for us is, of course, our American Airlines portfolio which is a large part of our business. It's a meaningful part of our receivables. We slowed down production there, and that's the most super-prime portfolio we've got. And when that part of your book stops and the rest of it carries on, you just get a business mix shift. The stuff that carried on, I mean it's fantastic stuff. These are all household names like Apple and so forth, and really very attractive risk returns. We feel really good about the business. So in some ways the underlying delinquencies really don't feel at all concerning to us, but there is a noticeable shift in mix. I think that now the American Airlines [portfolio] has switched back on, that shift in mix – the American Airlines [portfolio] will, I think, grow reasonably rapidly, it's been a very successful portfolio for us and that will just change the risk characteristic of that portfolio – and that will be reflected in the relative impairment charge.

So I like to think the portfolio continues to grow. I'd like to think that that new growth will be more influenced by the American Airlines [portfolio] than it has in the past and that will be reflected in the impairment charge. So hopefully still a growing business but the impairment will be reflective on slightly different business mix in that growth.

Regarding European equities, I'm not sure about your point about allocating more capital to European equities. I wouldn't put it in those terms. In terms of financial or regulatory capital it’s a relatively capital-light business. So it’s more, can we generate better returns from the footprint we have. Actually you can see one of the things that Jes did when he first came into the country, he actually trimmed our European equities footprint to make it more focused and concentrated. Tim Throsby who’s joined us a couple of months back, he’s an equities thoroughbred in some ways, and he knows that business very well. So I think it's an area we would like him to have a real hard look at to see if we’re achieving what we should be achieving in European equities.

But I don’t think that at this stage, I don’t think you’ll see any reallocation away from our UK business. Even if we had spare capacity capital be put into European equities, I think it’s more a case of sweating what we’ve got much harder and making more money with what we’ve got rather than any fresh capital allocation.

James Invine, Societe Generale

Two questions please; the first one is, usually at this point of the year you give some outlook for what you’ve seen in January and February on the investment bank. You decided not to, so just wondering if there's something specific there, a change of style of guidance?

And then the other question is, just following on from Chris’ point on the US cards, growth in dollar terms ticked back up there. I think previously you’ve talked about the pricing for new deals getting a lot tougher, so was just wondering if you could give us an update?

Tushar Morzaria

In terms of trading guidance, there’s nothing more than that. I try to avoid giving trading guidance as a matter of rule. There was nothing; you should just take it that there’s nothing good or bad to be read from that, I’m just not into giving trading guidance so there’s nothing more than that; just a policy view on my part. It’s not that we’re having a bad trading performance and similarly you shouldn’t conclude
we’re having a robust trading performance; you should conclude nothing. It’s just something we’ll continue to be silent on each quarter so nothing more than that.

Regarding US cards pricing, it’s an interesting question. It’s a business we like a lot but we have seen really competitive pricing for new portfolios, and the only one we’ve added in recent times is JetBlue which was in the early part of 2016 or very late 2015, somewhere around that timeframe. And we haven’t added anything very significant since then.

And much of that is because this stuff does look very competitive. The pricing you’ve seen on some deals – most people just couldn’t participate in the Costco deal and some stuff that Cití’s done. They’ve got their own specific advantages around some things like that that none of us could replicate. These deals are quite dangerous if you get them wrong. These are long-dated contracts – the best part of a decade or quite often longer than a decade – and if you misprice them you can get stuck at 5% or 6% returns. There is really no easy way of getting out, and we have made those mistakes in the company in the past, fortunately on a very small scale then and some time back.

So the scars are still with us though you can’t even see it in our numbers now because the good deals that we’ve struck probably from 2011/12/13 through to 2015 probably. So we are very cautious and I think we’ve got a good balanced portfolio that we can continue to grow, and we don’t need to be rushing out to add more to it. But we’re always very interested when things come and we do take a look, but we’ve certainly been passing a lot more than we’ve bid on, and it continues to remain a very competitive dynamic as well.

Andrew Coombs, Citigroup

Just on Barclays UK, if we look at the annual trends, you’ve seen a small increase in NII, small decrease in other operating incomes, so the revenue is broadly stable, give or take. Could you just break out the NII and Non-interest Income trends between the three [business] segments? You obviously provide total revenue, but it would be good to get an idea of the moving parts there.

And the second question is coming back to the US cards book; if we think about the growth in international cards as a whole, very impressive growth last year, how much of that was due to big ticket acquisitions versus how much is underlying organic growth?

Tushar Morzaria

Well let me take the second one first. The way acquisitions work is that it takes time for them to ramp-up. So it is a deal effect but I’d say it is as much existing portfolios growing as new ones coming in. I’d say the only big new one that we’ve brought on is JetBlue, and that takes a while to ramp-up. But at the same time of course, with American Airlines we reduced production there so probably turns into a bit of a wash. The American Airlines portfolio is much bigger than the JetBlue portfolio, but JetBlue has a steeper growth curve, so probably washes out.

The US economy is very healthy from everything we can see. It’s a market that likes spending on cards and borrowing on cards, and the consumer is very comfortable with that, and with our product. So in a healthy economy it grows very sharply. We have been also growing the open market business as well, which is quite small in the scheme of things relative to some of the big brand US cards, but that’s another thing that’s helpful for us. But our core business is partnerships and that’s working well.

Then on interest income in Barclays UK, the three-way split; you’re right we haven’t disclosed it. I won’t throw out numbers, but to give you a sense of what’s going on behind the scenes, with mortgages; mortgages is an interesting one where front book margins have definitely been much lower, continuing to almost grind down in 2016 relative to previous years. For us as a business, that’s still a really attractive, interesting, business for us because even at these relatively low margins, it’s still accretive to
our stock of mortgages, which may be different from others. We don’t have a big standard variable rate book and various other things. So for us it’s still accretive net-net.

We have been quite cautious in making that trade-off between margin and volume, and have probably stepped away from certain volumes to protect margin. In fact, completion margin in the fourth quarter picked up for the first time in many, many quarters; you have to go back quite a few quarters to see the last time quarter-on-quarter completion margin ticked up. So we think it is making a difference, in that sense, to us. We’ve kept it under review; it is a live discussion whether we should recycle some of that up-tick in margins back into volumes; trying to get that optimisation of most NIII – so a trade-off between margin and volume.

But it still feels a pretty competitive market. You have seen two other bigger banks grow their books quite quickly in recent times, NatWest and HSBC very noticeable, particularly HSBC, very visible across all parts of the mortgage market. So it does make you think, it’s something we take on board, but we haven’t changed our approach thus far and probably won’t do in the near term at least.

In cards, again, that’s our highest margin business. Margins have been pretty stable in cards. You don’t get the downward pressure as you’ve seen in mortgages. It’s really a question there of how much growth do we want from the zero balance transfer market which has been the big market in the cards business. And we have the super long-dated balance transfer market that is something we’ve deliberately stepped away from. It’s not really impacting our margins much, but will impact growth and that’s again a very deliberate risk reward trade-off that we’ve made.

Business banking and wealth tend to be much more liability-heavy businesses. It’s something we’d like to actually deploy the asset side more, particularly in business banking because they tend to be secured assets, tend to be principals borrowing against their house and tends to be very good business for us. So we are open to lend to small businesses. There’s that societal thing that banks aren’t lending to small businesses, which I think is as much small businesses don’t want the leverage. I think that all banks, pretty much every business bank in the country, would be willing to extend credit to them but it’s more of a demand issue than a supply issue. But it’s something we would be keen to do. Margins are okay in that space but it’s a relatively small market.

And personal lending, that’s the other one. That’s generally a closed market product for us; if you want to borrow from Barclays on a personal loan, you’d have to be a Barclays’ customer rather than bank elsewhere. So it’s a relatively contained market for us as well. You do see, again, a lot of competition there; you’ve seen Sainsbury’s bank, for example, drop rates to very, very low levels. It doesn’t seem to affect us too much in the sense that we’re not following that pricing down. We threw out some stats on the number of loans we’re making through our digital channels which is surpassing our physical channels now, and still growing the business.

So given it’s a captive business for us – our own customer base – the distribution of our product seems to be working actually pretty well. If you’re a Barclays’ customers you’ve almost certainly got a pre-approved personal loan and it’s very easy to tap into that. The underwriting is very high quality, so it’s good for us.

Jason Napier, UBS

Good morning. Three questions please; the first was the contribution from the structural hedge was actually up £100 million year-on-year. I was just wondering if there’s anything to call out there, perhaps currency influences? My understanding had been that as a caterpillar hedge we ought not to see a big reaction to market changes, so any colour you could give on the sustainability of that contribution, even if it’s just for this year.

Secondly, the cost: income target in the Core bank is around 60% - thank you for calling out the comp change. I just wonder whether, while we all respect the fact that you’re not focused on underlying
adjusted, whether you could give a sense as to what the cost of restructuring, ring-fencing, what have you, might be in the Core? And if you’re not prepared to share the number on that, perhaps what the year-on-year [variance] might look like into 2017 – just an order of magnitude idea there.

And then lastly on the Non-Core that is rolled back, the Italian mortgages; after the Mediobanca deal, my recollection is it’s about £10 billion of balances. Surely that’s something that does need selling at some point? If you could just rehearse the facts around what the portfolio is, whether it’s open, who services it and that sort of thing.

Tushar Morzaria

On the structural hedge, it’s a slight modest tick-up; £1.4 billion to £1.5 billion of P&L. It’s very, very modest and there’s nothing I’d draw out there. The rate environment over the last year had that big V-shape, if you like, in the third quarter, but apart from that was relatively consistent. So that V-shape, because it’s a relatively long strip of swaps that refinance, after just one quarter it isn’t going to make much difference at all. Although, having said that, it is a long strip of swaps and we are grinding down into lower rates, so all things being equal, you would see less structural hedge contribution. I won’t throw out a number, speculatively, on the rate market, but you will see it begin to grind down.

I’ll be quite surprised, unless something really dramatic happens, if it isn’t actually lower year on-year. I wouldn’t expect it to be flat or up this year unless something really dramatic happens in the rate environment. But that hedge has been a pretty good thing for us. Even now, it’s still generating over £1 billion of net interest income which we wouldn’t otherwise have had had we not being running that duration profile.

[Ring-fencing costs] in the Core; we’re probably in peak spend. I know you’re looking for slightly more guidance on quantum and perhaps delta. I won’t give you that but the budget that we threw out there for UK ring-fencing – well, in fact, all ring-fencing actually, in terms of CCAR and everything else – was about £1 billion, and the bulk of that outstanding is being spent really in 2017. In some ways, not much left to do in 2018; we incorporate the ring-fence bank and we’re live publicly with CCAR, so all the construction work and model build and everything else, we’re in peak expenditure here.

That’s within our budget, so there’s no re-striking of that cost allocation to talk about. I think that gives us an opportunity in subsequent years as to how much of that do we start recycling back into the company, and that’s what I was trying to allude to in my opening comments. You will see us recycle some of that back in, but at the same time get to a 60% or below cost: income ratio. The way I think about that, and you guys have probably played around with the numbers here as well, we had about £16.4 billion statutory costs in 2016 all in, everything, nothing below the line, and about £22 billion of income in our Core business. If you assume flat income just for the sake of arithmetic, you require a little over £13 billion in costs to get to a 60% efficiency ratio.

So how do we get from £16.4 billion to a little over £13 billion? Well the £16.4 billion had £1 billion of PPI in there – you could probably look through that. We’ve guided to what Non-Core should take out this year; a bit more than a billion, so that gets you to £14.4 billion. We had the compensation adjustment charge in there, and so that gets you to about £14 billion. We’ve still got £400 million of fines and conduct charges, and these aren’t lawyers’ fees, these are actual selling old Libor cases and various things like that, maybe you can look through that. And you get to, more-or-less, mid-13s just on that basis.

So we don’t feel we’re that far away from being running the company at a 60% [cost: income ratio] or below already. So I think, Jes’ view is very much, rather than driving to 55%, it’s more in the company’s long-term interest to be holding just below 60% and reinvesting back into the company. And we feel we’re getting to the point where we have choices to make around that.

The Italian mortgages; it’s a little over £10 billion in nominal. They’re super high quality, there’s virtually no impairment on these mortgages. That’s part of the problem actually, they’re quite thin margin
because they’re very high quality, and we don’t have a retail deposit base that’s the obvious way to fund these long-dated mortgages. They have very low risk-weighted asset density, so they don’t consume a lot of risk-weighted asset capital, though obviously have some leverage in there. And like with anything else, [if we receive] the right price at the right time, we’ll absolutely be looking to sell that portfolio. We’ve outsourced the servicing, it’s not something we’re servicing for ourselves. And have been in discussions but haven’t found a price that we like, and we’re not going to be forced sellers at any price or anything like that. So it’s just a classic Non-Core trade-off; price versus inconvenience, and we’ll continue to make that trade-off.

Claire Kane, Credit Suisse

Two questions please. Thanks for the comments on the pension contributions; is it fair to look at it this way, perhaps, that, say, if your pension deficit may have doubled over the last three years to somewhere around £7 billion, that the contributions annually over a ten year period could be around £700 million a year, which is broadly in line with what you agreed three years ago?

Tushar Morzaria

So what happens is, when you do the triennial [valuation], you then roll for that calculation, we publish that. The last time we published it was based September 2015, and that was £6 billion. So £6/7 billion, whatever the spot calculation will be. And it is meant to be plugged over a ten year period, so in some ways you’re right. And every triennial could be different, but historically it tends to be lower payments at the beginning of the period, rising over time.

Which is why if you look at the last triennial [valuation], in the previous years we made £300 million contributions, and it’s beginning to step up now. And I imagine this triennial will have a similar shape. It probably almost certainly tends to be a hill-type shape, so low in beginning, rising up and then tailing off at the back end. And we’ll publish that once we’ve negotiated with the trustees.

Claire Kane

Great, that’s very helpful. And then, secondly, on the investment bank, I appreciate no comments on the first quarter, though perhaps you could maybe talk us through performance for the fourth quarter? Clearly in equities and FICC it was below where peers were at. And I think last time you mentioned areas like, I think, equity finance, you had low representation and what actions maybe you can take to address that or specifically what product lines you’re not taking share?

Tushar Morzaria

So actually we felt pretty good with our sales and trading performance in the fourth quarter, and it is coming out that this theme that we’re developing is that we’re much more volume-sensitive compared to our peers than price level sensitive. So the fourth quarter, there’s a big risk-on value in the market with equity markets hitting record highs and what have you. We just don’t carry as much inventory as many of our other peers so we’re just not participating in some of the P&L upswing you get when you carry that level of inventory or risk.

If you go back to the first quarter of 2016, it was the reverse effect where it was a big risk-off period and we outperformed many of our peers by some distance again, because we got more than our share of volumes that weren’t susceptible to the re-pricing of inventory downwards. So I think in the fourth quarter we feel as though we got more than our fair share of volumes particularly in places like credit where it is quite noticeable for us, and just didn’t participate as much as others would in a bigger risk-on rally, so that’s just our business model. I think it’s an interesting question if something does change in US regulations and more risk taking is allowed, maybe through a different interpretation of the Volker rule or something like that; it’s something we would reassess I guess. But the trading desks at Barclays are running well within their risk limits. It’s not a risk capacity issue for them so they have the capacity to take risk, much more risk than they are taking should they desire. But it’s not something that’s
inherent in our business model so it won’t be a risk capacity issue; it’s more of, do we want to just tweak our business model rather than a new capital allocation or anything like that.

In equities we did, probably, a little bit better than some of our peers. I think in all fairness we probably had a slightly weaker comp in the fourth quarter of 2015 compared to some of our peers, but nonetheless, as a relative matter we probably did a little bit better than most people expected. You’re right in the sense that I think one of the things that we’ve noted as we’ve been restructuring the investment bank is that we’re relatively, I think, underweight in equity financing compared to particularly some of the US peers. And again, with Tim Thorsby coming on board that’s something he’ll take a fresh look at and see whether we’re on the right strategy there or whether something we need to course correct.

So I think more to come on that. Rather than pre-empt where Tim may come out, we’ll let him do the work and at some point over the next few quarters I’m sure you’ll get an opportunity to speak to him direct on those kinds of things.

Raul Sinha, JP Morgan

Can I have two please? Firstly, on the UK I can’t help being concerned that the top line in Barclays UK is going to be down in 2017 given what you are flagging to us in terms of the spread pressure on mortgages and your actions on Barclaycard to step away from zero percent balance transfers. On that particular point, could you give us maybe the gap between the EIR and the cash rate on the Barclaycard zero percent balance transfers? Because the concern is, if you step away from that market you can see quite a big step up in churn rates away from you, and these are customers who are on very low cash rates for the company, but I guess you’re booking them at a higher EIR rate, so there could be a negative drag to the top line in Barclaycard in the UK?

So just some thoughts on, clearly the top line was down slightly in 2016; is it fair to assume that in the absence of a rate hike that trend is pretty well set in the UK?

Tushar Morzaria

Last year was interesting because we got a rate cut, so that immediately feeds through to some of our interest earning balances, and to keep the top line roughly flat – I take your point it’s probably just technically down but I’d think of it as more flat – we thought was a pretty good performance. And the backdrop, of course, margin compression particularly in mortgages, probably less so elsewhere. When I look prospectively, it’s a harder one to call. Assuming no change in the rate environment, we think we should be able to hold NIM broadly where it is.

What has been good for us is our liability balances have increased. And they’re really good quality current account balances and small business bank balances. So these are very operational and very profitable for us, so that’s helpful in the background.

I think we’ve done a pretty reasonable job of balancing... again we’re trying to maximise net interest income, and we’ve done a pretty reasonable job of balancing that volume versus margin trade-off and hopefully you can see that feeding through.

On the card business, although the zero balance transfer market is important, you shouldn’t overstate it. The super long-dated zero balance transfer is 2% of our balances, so it’s important, but 98% of our balances are other types of product. The product that is working out quite well for us is what’s called a combo product which essentially gives you a zero interest-free period, much shorter term, but gives you other customer benefits. So you’re getting a shorter risk, interest-free rate, but you may not get charged on purchases, whereas in the longer term zero balance transfer products you get charged on purchases immediately; you get no interest-free period.
And that product is actually working out well for us; probably more than half of our new balances now are coming through that product, so we’ve been able to reinvent ourselves, if you like, away from the super long-dated zero balance product to these more combo products with a shorter interest-free period but with other customer benefits. And that seems to be working out well for us. The only thing with the zero balance transfer market is that you have to be a little bit careful if you are playing in that space in the long-term; to be careful of adverse selection as a risk management matter and that’s why you see us pulse in and out.

But I don’t think I would be so nervous of a lower income in Barclays UK, rate environment to one side. I still do think that jaws in that business is something we’ll look at, and continue to look at. We had slight positive jaws in 2016, and that’s something that’s important to us. We’ve put out there the objective for ourselves to get to a sub-50% cost income ratio; we’re about 53% [in 2016]. But you should expect us to see improvements there and that should feed to meaningful bottom line improvement.

The other thing, of course, you saw in 2016 in the income line that’ll be less pronounced in 2017 will be interchange fees. We’ve got the full year’s effect of the regulation compressing interchange fees, which happened at the back end of 2015, so you’ve now got a more accurate comparison year-on-year. So I’m not as perhaps concerned on top line compression as maybe the question implied.

Raul Sinha

That’s really helpful. Just a second one to follow up on the pension; as I understand it, you’re going to have to split the pension scheme for the ring-fenced entity on a ten year view, and this triennial will capture that period. So can I just check the cost of the pension scheme adjustment; is that factored in the ring-fencing guidance or is that going to be separately built into the pension contribution cost?

Tushar Morzaria

No, the operational effects of, if you like, reorganising anything to do with the ring-fencing is included in that cost budget that I gave a year or so back now – the £1 billion. I can’t talk too much about exactly how we’ll reorganise the pension fund in the light of ring-fencing, simply because it’s with the PRA and the pension regulators for approval, and it would just be very inappropriate for me to be sharing that publicly while it’s pending approval.

But I feel reasonably confident that this will work out as we expect it to, and if all things go according to plan, probably sometime in the third quarter, this work will all have wrapped up and we’ll share it with you then. But I don’t think there’s going to be anything that is going to feel unusual in terms of the outcomes there, at least from what I can see at the moment.

Rob Sage, Natixis

I was just wondering on BAGL, looking at the performance there in sterling terms, there’s clearly been a currency impact, though the profits seem to be a little bit down in currency terms relative to 2015. And a lot of it seems to be coming through on a very significant increase in the cost base, and I’m assuming that it’s probably going to be in your P&L for another year or so. So I was just wondering what’s going on there and if there was any guidance that you might be able to give for 2017?

Tushar Morzaria

Yes I won’t give any more guidance than was given by the local management team there, so I’d really refer you to the comments that they made. Obviously, South Africa as a macroeconomic matter has its challenges, if you like. It’s had relatively sluggish growth and still stubbornly high unemployment, and that flows into the opportunity set that that business has.

But having said that, that bank is a high double digit – it’s somewhere between 15% and 18% – ROE depending on the macro environment there, and probably the most important line is probably
imperfections, just given the concerns around the potential sovereign downgrade and stubborn unemployment levels, and that’s been reasonably well controlled. Impairments have ticked up, but not in a way that was unexpected. I think risk control there has been quite good.

Returns still seem pretty attractive and it increased its dividend year on year as well, so for the economy it’s in, it’s a very well run, well controlled bank, and certainly on a valuation we would love to have at Barclays Plc if we get there. So I wouldn’t call that anymore guidance than you will have received locally there with their releases on the Johannesburg exchange.

Ed Firth, KBW

Can I ask a slightly broader question? If I have a look, you’re quoting Core returns somewhere around 9.4%. And if I hear the messages today, the cost income ratio is there or thereabouts, provisions are probably going to be going up from here, sounds like you need a bit more capital cover in any contributions you make to the pension fund. So I’m struggling to see what’s the good news we should be looking for over the next few years? Can we expect returns to increase or is around 10% what we should expect for the bank over the next three to five years?

Tushar Morzaria

Taking a five year view is obviously quite difficult to be very accurate on. I think making sure that we’re at 10% on a Group basis is our number one objective. These are big revenue numbers and a big cost number, so small moves on each of them does move the profitability line very significantly. So if you do improve your efficiency metrics by two or three points, and that’s really what we’d look to do, to get it to below 60%, it is a lot of bottom line, that starts moving the earnings per share and the returns.

I think beyond that, if you want to take a more beyond 2018/19 type view, areas of growth in the company, I think the US business continues to be really interesting for us - the US consumer business. We have interesting choices there; we are one of the, if not the, fastest growing card operator, although I suspect we’ll level off growth there very deliberately. We could stay just doing that. It’s been a really good business for us – the partnership business – it seems like we’ve eked out a competitive edge for ourselves and can do things that other banks find it harder to do.

We could go into other forms... you could cross sell into personal lending, consumer finance, instalment finance, stuff like that. With that customer base, it’s a very natural thing to do; you don't need a branch infrastructure and things like that. That’s something that could be interesting; white label products, going into store cards, simple opportunities there. As well as just growing; we’re the tenth largest card company in the US I think, but with 1% market share, so you could grow for decades and still be relatively small in such a giant economy.

Moving away from that to the broader payment space; we don't talk so much about it but we have the full ecosystem of payments, particularly in the UK from card issuing, through acquiring, through corporate payments, through consumer to consumer linkages like Pingit. I think we’ve got the full suite and I don’t think there’s another bank in the UK that has that full ecosystem of payments.

Monetising that, obviously it’s a very profitable business already just through the bits that we have, but there are more ways of monetising that, other things that we could do. That’s something that the management team are pretty focused on, and at the right time we’ll share some thoughts around the business opportunities there.

The UK business we talked a little bit about; we’re going to be a little bit indexed to the UK economy, but we would like to think that we can do a bit better than the UK economy. So certainly profit growth will probably be a little bit concerning if we’re consistently growing our topline quicker than the UK economy by getting into parts of the UK that we’re probably not as familiar with. So we’re going to be cautious there but there’s no reason why profit growth can’t outstrip that.
And one of the things that in the UK business we feel quite excited about is, if you go back several years, the balance of net interest income and fee income was more like a 60/40 type split, whereas it’s now like 80-85/15 in favour of net interest income. So that fee income has really been eroded away – partly through the way regulators view various products and services, and obviously PPI was a big generator of fees back in the day. But areas we have opportunities to grow that fee line is particularly around our wealth offering; Barclays Stockbrokers for example, it’s not really a wealth offering, it’s more of a discount brokerage model, but we are rolling out our DirectInvest platform which is a souped up version of Barclays Stockbrokers – linking that to a current account so if you open up a Barclays current account as a premier customer, you get a brokerage account just tagged onto the end of it. I think we’re the second largest trader of UK retail equities without even really trying hard; Hargreaves Lansdown is probably the first. There’s another product we’ve got going around that space which is called Origami which is a self-select investment platform as well. So there are areas in which we want to really develop our fee income. So very capital light, virtually no capital, and very additive to the bottom line – very high profitability.

And then back into the international business, you’ve got corporate and investment bank. The corporate business is well known and is very UK centric. Should we think about having the ability to clear Euros? That’s something that’s quite interesting, particularly in the light of Brexit. It would be a natural place to take the UK multinationals and allow them to transact in Euros – so something that’s very natural for us to do and we have a bank subsidiary in Ireland already so we’re really well set up to do that. Could that be a new revenue stream for us? That’s something new.

In that sense, I think we have more growth opportunities than perhaps some of our most direct UK competitors – we’re more geographically spread and probably more product spread, it’s quite an exciting place to be.

But near term objective is just to divest of Africa, wind down the Non-Core and get the Core comfortably into double digits. But beyond that I think there are lots of really interesting opportunities beyond that horizon.

Chira Barua, Bernstein

You mentioned that on delinquencies in the UK you’ve been surprised, and especially disconnect with consumer confidence. What’s your thesis on that? Why do you think UK delinquencies are this low?

Tushar Morzaria

The economy surprised on the upside regarding unemployment. When we go back to post-Brexit, Bloomberg economist consensus had something like unemployment at the end of 2016 at 5.3%, from memory. I think it closed [2016] at 4.8%. That’s a massive 10% miss in unemployment in the space of one quarter, so in some ways people have just got it all wrong in terms of predicting how resilient the UK economy is. But as we all know and a lot of commentators will say, who cares? What about the next six months and the six months after that, and I think that’s just something we’ve got to be really watchful of. We’re quite late in the cycle. We have had a lot of macro geopolitical type shocks and we’ve just got to be really mindful.

And you can see it very quickly in our data; we have access to such rich consumer data, we can see things real quickly and we’re just watching it like a hawk. But there is nothing that we can see in
customer behaviour yet that would suggest a stress in the system. It’s more customer sentiment that feels slightly different to customer behaviour and so it’s something to really watch carefully.

Chris Cant, Autonomous

Just on the pension, your cash contributions. If I think about what happened with RBS during the course of last year – they accelerated their cash contributions and saw an offsetting benefit in terms of reduced Pillar 2A requirements. So they guided at the time to at least 50% of the cash contribution effectively being offset in Pillar 2, and it looks like in the end it was actually more of the cash contributions that were offset in Pillar 2.

Given that you’re in a not dissimilar position in terms of accounting, or approaching a net accounting surplus across the schemes, should we expect a similar reduction in your Pillar 2 if you do end up with this capital drag during the course of 2017 from the cash contributions? And then would you be reducing your [CET1 ratio] target? How much of an offset should we expect there?

And point two on the UK mortgage market; your completion margin into the fourth quarter ticked up. I think there was generally a bit of spread widening in the back end of the year as spreads widened and the swaps came down going into the third quarter, and I guess there was a bit of lagged effect there in terms of your 3Q business coming through in your 4Q completion margin. So I’m just trying to think about what your new production was in the fourth quarter that we might see coming into the first part of this year? Are you expecting that to tick back down again?

Tushar Morzaria

On the pensions in Pillar 2, I won’t comment on whether we do what RBS did, but if you are in a meaningful surplus then there is the possibility that your Pillar 2A charge does reduce. The reason I’ve got to be a bit cautious is, of course, we’re not really meant to share the inner workings of Pillar 2A publicly, but I think it’s a reasonable assumption you’re making – that if you’re in a meaningful surplus then there is a logical read across to a benefit in Pillar 2. That’s probably all I need to say on that unless there’s something else that you wanted me to get at that I didn’t touch on.

On UK mortgages, on completion, the point I was making is less about the actual shape of curves or spreads themselves – it’s just our production in managing volumes versus the rate at which we’re producing new mortgages there. It’s that balance of margin versus volume. We did tick down a little bit in market share very deliberately, but we saw our margins relatively increase.

Where I see that in the first quarter, I think it should hold up as it did in the fourth quarter. These are, of course, small numbers. We have a £120 to 130 billion mortgage book if you include our wealth business as well, so when you’re producing, we called out £19 billion in gross production in full year 2016, so £4 to 5 billion a quarter, it takes a long time for that to feed into the actual NII line. It’s a slow moving business in that regard.

Jonathan Pierce, Exane BNP Paribas

Another two quick ones on the pension; can I press you a bit more on this Pillar 2A point, because if the deficit is, as some of us in the room have figured out, maybe £7-8 billion, post-tax that’s nearly 200 basis points of the equity tier one, so there just isn’t going to be enough Pillar 2A there given all the other things going on to offset that?

So I’m really interested in what your view on the end-state target could be in the longer term taking all of this together, because based on the current timing of the contributions, if that rolls through into the next triennial, we’re going to get most of the payments between 2020 and say 2024, which is going to be about 10p of free cash flow absorbed every year, which is obviously very big in the context of the normalised dividend that maybe the market is starting to think about. I know it’s a long way out, but
maybe you could give us a little bit more colour on how you might start to think about dividend payments against cash contributions post your end-state in 2019?

And the second is, could you just quickly outline what the Section 75 payments were in 2016, and again I’m thinking ahead to a broader Section 75 issue into structural reform?

**Tushar Morzaria**

So on the cash flows, of course it depends on the position of the pension fund actually at that point in time. So if you assume nothing else changes and it’s permanently frozen at these levels, then again it will depend on the shape of the contributions. So I think it’s a very difficult thing… when you’re talking at 10p free cash flow, you’re talking about the best part of £2 billion – 1p for us is about £170 million. So if you’re talking about the best part of £2 billion, it’s unlikely that we’d have something as condensed as that. It will be probably much more of a thinner spread, but again I can’t give you too much guidance because of course we’re in live discussions with the trustees on this very topic. But if you look at historical numbers, it does not tend to be that bunched, it will be spread out more. And there will be drivers… if your deficit increases, it’s a bit like what we are seeing in 2017 – there is a kicker, if you like, so the contribution increases. If the deficit reduces there will be a lower payment as well, so it will flex accordingly.

I know it’s an interesting investor topic, but it’s not something that I’m that nervous about with regards to distributions from the company. Again, looking at the earnings capability of Barclays in the next decade, I think consensus for us this year is 20p earnings, somewhere around that, and that’s still with the Non-Core unit and various other things that we’re going through – restructuring and finishing stuff off. It’s not difficult to imagine that several years out in the future, we’re 30 plus pence of earnings for example and if you’re making a contribution level that we’re making today of around £1.25 billion which is 6p of earnings or something like that, it’s pretty manageable in the scale of Barclays, and that’s assuming we’re still making contributions of that scale. It really depends on the rate environment, and obviously if rates back up, that diminishes super fast. But it’s not something that I really at all worry about in the distribution framework for us at all.

Another way of thinking about it, contextualising it, if we are running at about £50 billion of tangible equity and we really are generating a 10% return, we’d be making attributable profit of over £5 billion a year. So pension contributions of nought to £1 billion, if we need to make them, are very modest in the scheme of that. In terms of distribution policy, it wouldn’t prevent us from doing anything we would want to do in in terms of capital distribution.

The Section 75 payments, yes I saw your note that came out last night. Section 75 in the sense that Section 75 is the backstop that can be invoked if there is a real problem between ourselves and the trustees, and you go to more of a buyout valuation. There’s virtually no risk of that happening at Barclays and is not something that you should at all be worried about. On the £167 million you referred to in your note, we’ll get you an appropriately technical answer to that. But don’t worry about the overall Section 75 framework – it’s not something that’s a risk for us.

**Martin Leitgeb, Goldman Sachs**

It’s just a follow-up on your comment on your business in the US; could you give us, in terms of US profitability, of how much of that falls within the US IHC versus the branch? And secondly, in terms of DTA usage, from a tax perspective is the IHC and the branch seen as one unit or two separate units going forward? One of your competitors has been able to merge them together from that perspective. And the third, in terms of the US IHC assets going forward, should we expect them to remain around the $200 billion mark as it is now, or would you expect any meaningful changes either upwards or downwards?
Tushar Morzaria

I’ll try and do them in reverse order. US IHC asset base of $200 billion – I don't think you’ll see significant increases from there, maybe slightly down, we’ll see. Do we have a single US tax group for the US IHC and the US branch? Yes we do. Regarding split of the profits between branch and the IHC; it’s not disclosed.

With that, thank you very much. I appreciate you joining us again.
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