

**Barclays PLC Q2 2016 Results****2 August 2016****Sell-side analyst breakfast transcript (amended in places to improve readability only)****Tushar Morzaria, Group Finance Director**

The key messages for us in the quarter were a list of four or five things that I've repeated for a few quarters now, with double digit returns in our Core business continuing to be very important for us. We were able to demonstrate this again in the second quarter. We put up a slide that just reminds people that we've been having to increase our profits, as our capital allocation to the Core business increases, to continue to generate that double digit return and we've been able to do that quite successfully. You get some dips, because of the bank levy coming into a single quarter, but looking past that it's important for us that we continue to be able to demonstrate those returns. Within the quarter the balance across Barclays UK and Barclays Corporate & International felt okay; Barclays UK is still punching at a relatively high return on tangible equity of over 18%, Corporate & International coming in at close to, just under, 12%, so we felt quite good about that.

Capital build continues to be important; we're probably more comfortable as a general statement not having to accrete capital every single quarter, which is what we've been doing until this year. If you recall, we went backwards by 10 basis points in the first quarter and there may be situations like that in subsequent quarters. I think we're much more comfortable with our capital trajectory and end state, and will navigate to that in good time, but happy to balance the opportunity to generate returns along the way. If we can use our capital productively in that regard and still get to our end state requirements in good time, then we'll take the opportunity to do that.

We guided to de-consolidate Africa over a two, three-year time frame and the pipeline of disposals that we have in the Non-Core that are business related. Based on this there's no reason we shouldn't be getting to 100 basis points or higher, and that should be very helpful in our capital trajectory; obviously you've got conduct and litigation coming the other way, which is less certain.

In Non-Core reduction, the other pillar of what we need to get done, £4bn of RWA reduction, was probably a little bit lower than we would have liked because of the last part of the quarter's currency

effects and market volatility. This inflated RWA's a little bit, otherwise it would have been probably a more headline-grabbing reduction. But we're on track to close our Non-Core unit, or really fold our Non-Core unit back into the Core, by the end of 2017, and still targeting around £20bn or so of risk weighted assets. A lot of that will be predicated on what we can do between now and year end.

We gave some guidance on what to expect in costs in Non-Core, £400-£500m next year, and we guided to negative income this year of £800m-£900m. If you think of that as a budget, we've got a reasonable amount to spend this year and we'll try and use that as productively as we can in a capital neutral, capital accretive way, particularly around some of our derivatives portfolios. When we looked at consensus, essentially your numbers coming into us for Non-Core, reaffirmed that for the full year your pre-tax losses felt about right to us as well, so that should help you in terms of modelling the Non-Core, which I know is much more difficult.

In terms of overall costs for the Core business, we reaffirmed guidance of £12.8bn, taking into account currency effects if the pound [to dollar] stays at around the low 1.30's, somewhere around 1.30 for the rest of the year; it's probably going to inflate our costs by about £200m, we'll see where currencies go for the remainder of the year.

The only other guidance that's worth mentioning now is just for net interest margin; we also guided to broadly stable net interest margin in the high 350's, approaching 360 basis points, in Barclays UK. If we were to get a 25 basis point rate reduction this week, we think we should be able to pass on that 25 basis point cut on our liabilities side to preserve NIM. There's a delay effect, we've got seven million people we need to write to twice, so it's quite a cumbersome process to pass those cuts to savers, however we think we can get that down, keep that interest margin broadly where it is in the second quarter. If it goes down again from there I think that will put downward pressure on our NIM. I think we're running at capacity on our liabilities side to pass much more on, so we'd have to look at other levers, maybe the asset side pricing, levers like that.

Finally some of you may have already seen there's a consultation paper that has come out from the FCA this morning on PPI. I can't say I've really digested it properly, but I want to remind people that we were working on the assumption that the two year consultation, that was part of the last consultation exercise, was going to happen. Our numbers are based off that, so instead we have a new framework to implement, we will obviously look at that and then see what that does to our numbers. But that's all I can say on that at this stage.

**Joseph Dickerson, Jefferies**

Just on the net interest margin, could you refresh us on the hedge guidance that you gave on the call?

### **Tushar Morzaria**

Yes, so we have an equity structural hedge and product structural hedge, as mentioned in previous calls, we target a five year duration in our equity structural hedge, a lower duration in our product structural hedges. The way we construct those hedges tend to be through swaps and for the sake of simplicity, imagine you're targeting a five year average duration, we would run a strip of swaps going out to ten years' duration weighted so that the average duration would be five years, roughly speaking evenly by one year, two year, three year, five year etc. So every year, if we continue targeting a five year average duration your one year maturity swap disappears and we replenish it with a duration weighted ten year position. We think of that as a caterpillar, given it just runs down. For example, if rates were to continue to grind down, we would grind into lower and lower rates, and that would effectively feed into our NIM over time. If rates were to grind up you'd have the reverse effect, so we'd grind up gradually. So it's essentially a delaying mechanism, it's a smoothing mechanism; you won't see the full effect of a rate rise or a rate fall, it will come in over time. Where that could be particularly painful could be your grind down to zero over some prolonged period and rates immediately set back upwards and stay there. It would take us a long time to grind back up. So who knows what the scenario will be but that's probably the one we would be vulnerable to. We are rolling our hedges out, and we try not to take views on rates and it's mostly in swaps rather than securities.

### **Martin Leitgeb, Goldman Sachs**

I was just wanting to ask you about the stress test results from the EBA on Friday evening. What is your thinking on the outcome there in terms of Barclays being, in terms of stressed Core tier one ratio, one of the lowest among the European peers, out of the 51 banks, as at December, and how we should think about that? Thank you.

### **Tushar Morzaria**

Given the methodology for the EBA stress test, it's noticeable that the two UK banks that have probably fared least well are ourselves and Royal Bank of Scotland. I think for those banks that are going through a restructuring, the methodology doesn't work as well. The things that affect our numbers through that methodology are the cost projection. You've got to keep your 2015 costs flat and run it all the way through the scenario, that's very improbable in what we're trying to do. We're trying to front load a lot of the restructuring charges so that we don't incur those costs in outer years, but that's a negative effect on our numbers.

You also get a slightly odd treatment for the trading book as well. You look at your historical trading income, trading revenue volatility, which I can see why that makes sense. However, because we've been decreasing the size of our trading book, you've seen a steady decline in revenues from the peak of around 2012 all the way down, which is quite orderly. You could almost draw a line through it, but it

actually has a high standard deviation so you get a very magnified trading shocks that are like over 1,000 times our VaR. You get into some really odd-looking numbers.

So those two things are quite penal for us. The Bank of England were fully aware that these parts of the methodology probably aren't exactly designed for this kind of institution, but nonetheless they are what they are. I think the Bank of England said in their [release] you shouldn't read across the results to the Bank of England [stress test] because it's a different scenario and a different framework, and that's probably the one that really matters for all UK banks. That's the one that will effectively drive our capital decisions.

#### **Martin Leitgeb**

Could I just follow up on that one? If I look at the EBA at worst scenario, and their stress applied to property markets in the UK compares comparatively light to what the Bank of England is doing this year round. Does that matter for the result or is it mainly driven by unemployment in terms of where we see the threat to impairments for Barclays?

#### **Tushar Morzaria**

In impairments, we are vulnerable to real estate corrections. You saw that in the 2014 Bank of England stress, but that's similar to the stresses we do for our own internal tests. What we do is we take the Bank of England stresses, which will give you the headline negative HPI for some housing, but when you then fill it in for the parts of the geography that matter most to us and take it down further. So if there's an average decline in the UK of x per cent we would expect London to go substantially down more than that, and we share that with the Bank of England and I assume all banks do a version of that. So it's probably more the banks themselves that take the banking stress and stress ourselves, perhaps more specifically, so we look for, in housing for example, the geographies that matter and take house prices down even further than the Bank of England's average. The other part that we are vulnerable to is unsecured credit, and again the 2014 stress was quite a deep stress. Now that's less sensitive to unemployment levels, it's the speed at which unemployment kicks up that is most sensitive. A very sharp, dramatic increase in unemployment would affect our unsecured credit quite materially, and that's what you saw in the 2014 numbers.

#### **Manus Costello, Autonomous**

Can you just fill us in about the changes to the provisioning methodology in Barclaycard UK, which seem to be a series of recurring one-offs which keep coming through?

#### **Tushar Morzaria**

Usually I try and tell you in advance when these are happening but depending on when the work's being put together and results have been finalised sometimes I get an opportunity to do that, sometimes I

don't. I wouldn't make it into a bigger thing than it is; it's not changing the impairment run rate at all. We refine our methodologies, recalibrate our models periodically, and it's not just in Barclaycard that we do that, I mean that happens everywhere. We've done this, back end of last year and we've put another one through in the second quarter. The second quarter is slightly exaggerated, there was a debt sale actually in the previous year as well which was a credit, so it was the combined effect that was about £50m; only a part of that was the model refinement. We do have one more that we do want to put through; I don't know if it will be Q3 or Q4 yet. It will be of a similar quantum, so again it won't be a sort of a step change up in impairment, but we're just working through the testing of those changes to make sure that we're comfortable with them. The most important thing is, as I say, I try and call them out in advance, they're not meant to be that frequent. You might get a refresh once every year or two, we've got a little bit of catch-up that we're going through at the moment, but the most important thing is really the underlying delinquency levels, as yet, haven't changed, they may do in the future.

#### **Manus Costello**

What are you actually changing, out of interest, in the methodology? Is it a LGD assumption, or a PD assumption?

#### **Tushar Morzaria**

It's the way we think of forbearance; so it's the way we look to gauge the outcome of certain forms of forbearance that we apply, and we constantly refine that based on experience to make sure we're getting to the right projected outcome.

#### **Raul Sinha, JP Morgan**

Could you maybe talk about a couple of things? Firstly, on PPI; you put a £400m charge through in Q2 which was a little bit of a surprise, if you could talk about the driver of that. And then maybe any comments that you've got on what an extra year of deadline, June 2019, looks like? And the second one is on costs; I mean the £12.8bn, £13bn for this year, can we get some sense from you in terms of how much SRP / litigation type costs are already baked into that number? And if you could update us on where you are, in terms of your spend on the SRP costs, that would be helpful.

#### **Tushar Morzaria**

On PPI the £400m million was almost entirely taken by remediation programmes. We have some remediation that we have to do ourselves, so what tends to happen, and this can be a little bit frustrating for us, sometimes we don't have perfect data but you try and get to the best customer outcome. What you tend to do is skew to be somewhat generous to the majority of customers, but it turns out it can't be generous to every single customer. The claims management companies are getting very smart at this, so they may find someone and determine actually this wasn't that generous to this particular customer - that customer claimed to the FOS', and the FOS say 'well you've just got to do this

for everybody' and that's what we've been caught out on. The other one, that was more material, was a third party. We had a card portfolio that we sold. I think it was 2005, so we're not doing the actual PPI administration for that, that's with the person that purchased the card portfolio, but as part of the sale purchase agreement we indemnified them of losses on our watch, which these belong to. It's their remediation, so they didn't administer PPI redress properly and that's a source of frustration for us as well that we can't control that process. But these things happen from time to time so that's that. The one year, so I think that's referred to in this morning's release; I should have a proper read through that before I send you off on different tangents on what this mean for us so I probably shouldn't comment on that yet.

**Raul Sinha**

But the claims rates look like they're heading downwards in line with the competition

**Tushar Morzaria**

Yes, that's right; I suspect from those, and we'll see what the other banks report this week, but I think so for ourselves and Lloyds. We commented on claims actually below our projections so there's some hope for us there. But I haven't got the details on the one-year timeline. I don't know what all that means yet.

On the structural reform costs, no change to the full spend that we guided to last year. It was going to be relatively front loaded so 2016 and 2017 are the two big years, it virtually needs to be done really by the end of 2017 so that we can flick [the switch], so to speak, in Easter 2018. Think of it as a relatively evenly spread across those two, so if you've got £1bn and most of that billion pounds is being spent in 2016 and 2017 with a little bit before and a little bit after; I haven't quoted exact numbers but it gives you a sense of the shape.

**Raul Sinha**

And then on the litigation?

**Tushar Morzaria**

We haven't given any specific guidance on that; we'll try and absorb regular way litigation, if there was a very significant number then we'll call it out. So for example, take RMBS if that were to happens, that we'll obviously call out separately but regular way stuff will just flow right through.

**Chris Manners, Morgan Stanley**

A couple of questions if I may? The first one was on capital, so we've had the countercyclical buffer being eliminated in the UK, so I saw you brought down your capital stack, you've got 11.6% as the CET1 ratio at the moment so you're probably going to need to run at 12.5%, so you're almost there. Do you

actually still need to sell Africa? Do you still need to take maybe as strong actions as you're taking to build capital? And do you feel a bit of relief there?

The second one was linked, but on the disposal of Africa, could you run us through what hurdles actually you need to do to be able to fully sell that? So will the South African Reserve Bank be happy for you to just sell it into the market place? Are you still operationally intertwined with Africa? And maybe just explain a little bit of that to us, Tushar, Thank you.

### **Tushar Morzaria**

On the capital, my sense is that the buffers, whether it's counter cyclical, whether it's G-SIFI will recalibrate up and down, hopefully down mostly, but I suspect somewhere around 12.5% is probably still the right number for us, even if we get some relief from the G-SIFI surcharge. In theory we could start running in the high 11's to be still materially above our Basel buffers but the miss is the capacity to absorb stress testing draw down, and you don't know what stress tests will happen in any one particular year, so I think you need to be prudent in managing that buffer. 12.5% still feels like the right number and that's what we'll continue to target.

Now in terms of do we still need to sell Africa to get there, we never really sold Africa because we needed to raise capital. It was a strategic decision when Jes came in and looked at the business. We've probably gone through this before but it's well worth reminding people, when he joined we had somewhere around 130-135,000 people in the company, with 45,000 colleagues in Africa and 12 countries generating £300 million after tax profit, a 1.5p of EPS kind of thing, or maybe 2p if you round it up. For that profit generation with that amount of headcount, people, distance, geography, lots of changes in bank regulations are we an advantaged owner of this? Jes concluded we weren't. The friction cost for us owning it were much higher than if people wanted to own it directly. The synergies that we could extract out of it didn't offset the friction cost for us owning it, so it was really driven by that. It of course gives us a lot more comfort and confidence that we'll get to our capital end state in good time.

### **Tushar Morzaria**

With regards to the operational and regulatory hurdles with South Africa, we'll have to agree what's called a Transition Services Agreement; part of any regular M&A assignment. We are probably more intertwined, Barclays Group and Barclays Africa than your typical, self-contained subsidiary. Some aspects are really simple, for example, they use our email servers; that's relatively easy to change. Other things are slightly more ingrained, e.g. some risk reporting to be done on a single platform.

The South African Reserve Bank and the Government of South Africa will need to approve the next sell down because when you go to a non-controlling stake, so when you go below 50%, you need

Government approval to do that. Our expectation is that the South African Reserve Bank approves it and the Government will really just want to confirm the shareholder register which I would assume is a relatively straightforward task.

The South African Reserve Bank will look at the operational stability of Barclays Africa and will need to be persuaded that it can stand by itself, which of course it can and will. The PRA interests are quite aligned; the South African Reserve Bank wants to be the primary lead regulator for Barclays Africa Group and they are incentivised to get to that point. I think the PRA would be quite comfortable if they didn't have to regulate Barclays Africa Group, so they'd be quite happy to get us to that point. We'll work through the TSA, which is more complicated than you would normally have in an M&A assignment, but it's one that we'll work through with the local team and then need Government approval. That's why we will never put a clock on this - these things will take a bit of time.

#### **Chris Manners**

Could I just follow up on the capital point, if you need 12.5% and you do sell Africa which would deconsolidate a lot of RWAs and you should still make some profit, your capital ratio is going to go quite a lot higher than 12.5% and so how should we think about what you do with any notional?

#### **Tushar Morzaria**

Well there's unknown conduct and litigation and you make your own estimate as we do on that. So even with that if we feel we've got too much capital it's a high quality problem; you've seen us do things that we can do on our liability side of our balance sheet that we've taken some advantage of. This is a longer term comment, but we'll balance redistributing that capital back to our investors which gives us a lot of pleasure, as well as recycling that back to continue to generate profits, but being over-capitalised is a nice problem to have.

#### **Tom Rayner, Exane BNP Paribas**

Just sticking on capital and seeing where Chris is going with those questions given what's happened with Brexit etc., have your thoughts on Basel IV and how aggressive the Basel committee might be in the final papers changed at all? Would you be any more or less confident that you can absorb the RWA inflation through reductions in Pillar 2A than maybe you would have been before?

#### **Tushar Morzaria**

I don't think my views have changed. It's probably too soon to really see whether there's a change in sentiment. It is a bit of an unknown. As you may know some of the consultation papers will have a very material hike up in UK bank capital which we know the Bank of England has made comments around. I suspect the negotiating power that the Bank of England has with the European authorities is probably different to what it was a month or so ago. However it's too early to see whether we've got a change in

sentiment or at least a change in planning assumption for us. We've always tried to be quite prudent in assuming a reasonable level of Basel inflation.

I think the other thing that's interesting and I don't know the answer to this one is, let's say Basel can get all its work done and in the committee agree, whether it's operating risk or standardised credit risk weightings, if that needs to be adopted into the CRR that could be a two-year legislative timeframe, one to two years with one year to implement, getting this out to about 2020 quite easily if you just watch the timetable go. Of course that takes us through a Brexit type timetable, hence it's quite unclear as to what to make of all of this apart from just assuming for prudent planning purposes there's some RWA inflation coming down the pipes and we should plan for it.

**Tom Rayner**

On that same point, the press is speculating about ring-fencing and legal status of deposits that might be in the EEA and whether or not this whole timing issue becomes a real problem, could you comment on that as well?

**Tushar Morzaria**

Yes, it's not something that's a huge concern to us. We constructed our ring-fence such that our European operations were in our non-ring-fence so for us our plans will still work. I know other banks that may have decided to put EEA deposits or similar activities in their ring-fence may want to revisit that.

**David Lock, Deutsche Bank**

Just a quick question on Barclaycard Consumer UK, if you look at the income yield that the business has had it was running about 13% in 2014/2015 and it seems to have dropped quite markedly in the first couple of quarters. I just wondered if you could give any colour. Is that fees and commission, is it margin? And then also on Barclaycard if you could just give any colour on topline and revenues going forward, and on the balance transfers and how you account for this?

**Tushar Morzaria**

So on the income line there is a couple of things going on there. There's the interchange fee cap that's been introduced so that does bring a downward pressure on our fee-based income. The other thing that went through in the second quarter in the income line which again it's not something big enough to individually call out but it helps explain why it was a little bit lower in the second quarter than you might have expected is CCA3. Given banks had significant issues within the past we had one particular issue in Barclaycard that we had to remediate.

This went through the income line this quarter. Again it wasn't big enough to call out individually but it does knock off some of the income performance associated with the fees. That will all reset next year, hence it's exactly as expected. Underlying the business looks quite healthy actually. Balances are growing at an appropriate level for us and net interest income is good and underlying delinquencies look well-managed at the moment now. It's only a month after a fairly profound political change in the UK so we're watching it extremely closely but thus far it looks in pretty reasonable shape.

In terms of the accounting for Barclaycard, there's nothing that we do that you wouldn't expect us to do; effective interest rate calculations and it gets passed through over the behavioural life of those products just like we do for mortgages, just like we do for the US cards business so nothing unusual about that at all.

### **Chintan Joshi**

Can I focus on the investment bank? The UK's probably getting into a slowdown or a recession. European growth may be a little weaker over the next three years/four years; chances are you might get a US recession or at least a slowdown. So when you think about the revenue outlook from current levels I know you don't assume any kind of growth in revenues that might worry us, but still the outlook is not great. The capital lever was taken off the table with the strategic review - when does it come back on the table? That would be the first question.

And, second, just on the NIM, what is the weighted average cost of deposits in the UK just to give us a sense of how much liability cost can come up over time?

### **Tushar Morzaria**

On the CIB, we don't record the IB separately anymore. The CIB in aggregate had a 9.5% return but it was reasonably even between the IB and the corporate business. The corporate business actually because of the big hike in UK taxes brings down the profitability, so we will look to make our assets more productive; 40% increase in your marginal tax rate makes a big difference to a UK centric business. Over time, in the slower moving business, if opportunities to refinance occur, we'll look at those that still make sense and re-price those where we can.

So I expect there to be ROE improvement on the Corporate side of CIB that will come through over time. It won't be immediately, but a one, two, three-year timeframe. There are cost opportunities that we continue to go after. I imagine this is a permanent state of affairs in a business as it matures out. And I think there'll be several years' worth of continuing efficiencies we go after. Even in the front office, we're running them as an integrated CIB, traditional corporate finance and corporate coverage banking. There are opportunities to make that more efficient. There are some infrastructure opportunities particularly around loan processing.

I'd say capital's never off the table. In that sense we will reallocate capital if we can to see a better mix for the company, a better through the cycle return of the company. We've taken a lot of capital out, particularly on the IB side of CIB and we want to be cautious that if we still feel we want to recycle capital away from there it doesn't turn into a net negative. You need a certain scale and presence but you can do a negative feedback loop if you're not careful.

We look at that through our business reviews. The other thing that's very important for us is a structural reform matter and we've set the bank up to run two banks, Barclays UK and Barclays Corporate & International, and so we've got to look at it on the entity basis as well when we're thinking about capital allocations, diversified returns, size of our balance sheets. So all of that goes in together. But I wouldn't say anything's off the table and we'll construct the right balance sheets to make the most of the resources that we've got.

On deposit costs, I think everyday savers are at 40 basis point which is the bulk of our retail deposit savings accounts and if we price that down we'll probably price it down to 10/15 basis points. We'll do it in one shot and then you're virtually there, you can't do much more than that.

#### **Fahed Kunwar, Redburn**

Just following on from that question on the Investment Bank on the income, if your income is flat and 0% [growth] going forward and you're focusing on costs what kind of jaws are realistic in that business? You had a 4% cost reduction year-on-year this quarter but income still came down 6%, your Core jaws were still negative as well. I mean, what is realistic in that business?

The other question was on passporting, you gave some detail on the call saying the bulk of your revenues in the investment bank aren't really affected by passporting. Could you go into some detail on how and what business it could affect and why you're so confident it wouldn't be an issue?

The third one was a follow up on the PRA paper on mortgage risk weights that came out on Friday, just a sense of how they're going to impact on your Core Tier 1. Thank you.

#### **Tushar Morzaria**

I still think it's realistic to be able to generate at least the same amount of revenue. People have said before we're not trying to project inflation in revenues with a lower cost base and I think that's a true statement, not for the short-term but perhaps the medium and indeed the longer term. The only aspect that you can never decide in advance is the variable component of compensation that will need to vary as it would with the top line. But outside that there's a lot of what we can do and it's a multiyear, very mature industry. We had a relatively fragmented infrastructure, relatively siloed. It grew very quickly, unravelling all of that is a multiyear project. I think there's lots of opportunities to keep going after. It

can be a little bit frustrating because there are restructuring charges, but at some point you can start seeing the benefit. It does get masked by restructuring. Jes was keen to stop disclosing restructuring charges is because people think it's a free pass and that doesn't work for him obviously, so it's better restructuring is within [businesses] own capacity.

And Barclays UK is a good example of a division that's now an entity that can really self-fuel their own restructuring and find enough reinvestment capacity. I do think there's a long way to go. I don't think it was ever going to be a one, two, even three-year journey. This is a multiyear journey and we continue to do it every single year better and better and better.

On passporting revenues, the real answer is that we don't know precisely, simply because we've never configured our accounting systems to count passported revenues. You've got to go through all the activities that may or may not require a passport and then ask our financial controllers to go away and count the revenues and it's quite a complicated process as you can imagine. When I look at proxies for that, whether it's revenues booked in Euros, whether it's revenues booked with European clients, [these are proxies these aren't the exact numbers], I think what we're trying to say is that it's not as big as UK bank ring-fencing or as big as [the US HoldCo].

It's probably not as big as IFRS9 in terms of the infrastructure overhaul. It's not small, I'd rather not do it and use the capacity productively elsewhere, but it feels a manageable scale for us. I don't think we're unique in this unlike, say, UK ring-fencing or even for that matter US ring-fencing where you can have uniqueness round this. This affects any international bank operating through London and we're going to have to look for other avenues to passport activities. I don't see how we can be any more disadvantaged and possibly at the margin even slightly advantaged compared to others. However, note it's too early to be too precise around that. I didn't want people to think it's like UK ring-fencing or [the US HoldCo]. I don't think it's of that scale.

On mortgage risk weights and the PRA consultation paper, when I looked at our [book] compared to peers, and obviously I don't know exactly what our peers do, but I look at our risk ratings and I look at our risk weights. I think we're quite conservative from everything I can see. As a relative matter I think we'll be impacted perhaps relatively less than some others, but that remains to be seen. That's probably all I can probably add to that at this stage.

**Michael Helsby, Bank of America Merrill Lynch**

I've got three please Tushar. Just on costs, but thinking outside of the CIB. As you look forward there are so many revenue headwinds that seem to be presenting themselves with lower rates and lower loan growth. It does strike me that, we've all been focusing on the CIB ROE but the headwinds feel much

bigger in the non-CIB business from here. So what can you do to change that outlook because obviously that's where the valuation sits?

Second question would be on the ECB and the corporate bond purchase programme, and maybe we'll get a corporate bond purchase programme from the Bank of England, but how much of your corporate book, i.e. the issuers or the borrowers, would be eligible to re-finance and then be bought by the ECB. It strikes me that that's quite a big potential re-financing headwind.

Finally, just thinking into next year, and let's say the economists are right, and we are going into a recession and the outlook is tougher, how do you as a CFO think about IFRS9, and do you smooth into that, or do you just have a big step change at the end of the year. How do you think about it from a provisioning point of view?

### **Tushar Morzaria**

Barclays UK, we feel quite confident that we can target a cost/income ratio below 50%. We had positive jaws in there in the last quarter and 53% cost/income ratio, which is okay, but really should be better than that. Within there you've got the card business, which is super-efficient, and that's sort of a nice tailwind, but then you've got the wealth business, which is less efficient. And so that probably evens itself out a little bit. We've seen, when we look at peer analysis there's no reason why we can't get into the 40s over time. If you look at Barclays UK top line, it has been broadly flat for some time now, for one reason or another, but profits have grown, and it has been through the ability to really take out proper costs in the aggregate, that flow through to the bottom line.

We will continue to do that. We have 1,300 branches and we don't need all of them. We'll continue to utilise digital channels more, which is actually better from a conduct perspective as much as it is from a customer experience as well. Cost/income ratios are much lower through digital channels. At the same time, switching off physical channels.

When we created the Barclays UK construct, it's been identified there's really only nine product services that we do. Whether you're a private bank customer, a mass affluent customer or a regular retail customer, the processing engine behind you should just be one of those nine platforms.

The look and feel and the customer experience may be different, but the bulk of the costs are in the physical processing. Ashok has done a lot of good work on simplifying, condensing it all down. So if you're a private bank customer and you take a mortgage out, you would think a mortgage is a mortgage at the end of the day. It might feel different as a customer experience, but the processing of it [will be integrated], and that's what he's been able to do, and that will continue to come through over time.

The Barclaycard and the Retail businesses have been managed very separately as an infrastructure matter, and quite successfully in both of them. However, you can pick the best of both breeds from those mass processing platforms. Call centres have been run differently, collections and things like that where you've got unsecured credit in retail and you've got unsecured credit in cards, you can have a single collections unit that can do it.

So all of those things we're getting after. We now have Brian Cole running Barclaycard UK, who came from Capital One, and so he's come in with a fresh perspective, no baggage of how things were done in the past. So I feel actually quite optimistic on that side.

### **Michael Helsby**

Are those lower costs in absolute terms?

### **Tushar Morzaria**

Yes, absolutely. Absolutely. It's not a 53% going to, say, '47%' because income's going up, it's assuming no income growth, and potentially, like you say, probably some downward pressure on income.

On the ECB non bank bond purchases this could be quite an interesting opportunity, in the sense that European debt capital markets has tended to be a very good business for Barclays. We tend to punch above our weight there, operating in the sort of number one/two slot in that space. If there is a flurry of activity, whether it's in the UK or in Europe, of people wanting to re-finance an issue of securities to take some advantage of ECB buying, which I'm not sure is as strong a bid as people might think it is, it may materialise and become stronger over time. That ought to be very helpful for our business, and we did see a little bit of that in Q2, but it's still early post the ECB's announcement. I think give it a bit more time to see if that's got real momentum behind it, however, I think that should be a net positive for us

On IFRS9 the two things are the regulatory application of IFRS9 and the accounting switch. One the accounting switch, to the extent under current accounting we could take more general provisions, and we'll do what we can, but I think there's limited scope to do that, you'd be in breach of current accounting standards. You can't just take provisions as you no doubt know.

But the regulatory applications are just as important. Ultimately accounting changes will be fine, a one-step change most people see and understand what the book value impact on the bank will be when it gets reset. I think it's the regulatory capital theme that we will probably have less visibility on. For example, there's an expected loss over impairment deduction already taken against capital. Will that be

removed? Will it be graded? Will there be a regulatory filter applied to it? Those are quite important decisions that Basel and policy makers will need to make.

That's what we've urged, for them to provide as much clarity sooner rather than later. It's not only just the step change, it's also how capital will behave, in a post-IFRS9 world, as well.

**Michael Helsby**

Thanks. Where are you allocating the structural reform costs? Is that in the UK bank or CIB?

**Tushar Morzaria**

For UK ring-fencing it's in the UK bank, for the US ring-fencing in the CIB, so it covers both CCAR/IHC, as well as UK ring-fencing.

**Jason Napier, UBS**

Tushar, thank you for the comments on CIB. I appreciate you were asked in the call whether you'd look back at the second quarter and want to call out sort of lumpy or particularly strong features, but given the impact of restructuring costs and FX and Brexit and the list is endless, just on a pre-provision profit basis, do you think into what ought to be a seasonally slow second half you can sustain what you've produced in the second quarter?

**Tushar Morzaria**

In CIB, or just generally across the whole Group?

**Jason Napier**

In CIB.

**Tushar Morzaria**

I don't think there is a reason why, as a relative matter, our market share or anything like that should change. What the third quarter will be relative to first and second quarter in terms of market activity is, your guess is as good as mine. I don't see there's any reason why we would, as a relative matter underperform. On the fee side, we tend to do very well when sponsors are very active, so we're slightly overweight sponsor activity. So in some ways what we don't have in the US we compensate by having overweight sponsors.

Bank of America/Citi they have their big corporate bank that funnels a lot of fee based business to them, and Goldmans have a brand that helps them probably get a disproportionate market share as well. We don't have the corporate business, we don't have the longevity of relationships in the US. So

where we compensate for that is on the sponsor side. When sponsors are active, which they have been, that tends to be good for us.

On the sales and trading side, I would say we are probably more volume sensitive than price sensitive these days. You might have seen that in Q1 and Q2, if you look at our sales and trading revenues, we were probably more even across the two quarters. I think a lot of peers were probably lower in Q1 and higher in Q2, and I think that's as much a reflection of inventory they may have been carrying that repriced down in Q1 and repriced up in Q2.

The way we would underperform in sales and trading is in a rising asset price market, accompanied by low volumes - we would probably underperform. Or if there was a lot of non-sponsor investment banking, if the corporates were very active and sponsors were completely quiet, we would probably underperform there as well.

I'm not sure whether I'd expect to see either of those two things in the third quarter, so I would have thought we'd hold up okay. Of course, if sponsors are more active and volumes are higher we should do a little bit better, which is what you saw in the first quarter.

#### **Jason Napier**

From a currency or a restructuring cost drag perspective, there isn't a huge amount to call out quarter on quarter?

#### **Tushar Morzaria**

Yes, currency will be what it will be. It might be a tailwind. It feels like it at the moment. Restructuring charges – there's more we want to do that we have in the pipeline. The exact calendar effect of that we haven't thought about. One of the things we've got in the back of the mind is our London based real estate footprint. That will have a restructuring charge. I'd call it out in advance if I could tell you, it's definitely coming. It may come in the third quarter, but I don't have enough certainty yet myself to call it out, but should be in the back of your mind.

#### **Fiona Swaffield, Royal Bank of Canada**

My questions are on Consumer Cards & Payments. A couple of questions, one was the revenue sustainability. I know every quarter we discuss it, it just seems to be repeating, and I think you mentioned a new American Airlines agreement, so if you could talk about that. The second was the jaws between costs and revenues, and is there anything unusual in the costs, or is it that the revenue growth is with no cost? I'm just struggling to understand that.

#### **Tushar Morzaria**

The American Airlines deal is a really good deal for us. You won't see the economic benefits of that deal until next year and beyond. It's a very sizeable deal for us. We generally believe it's the better part of the deal, because the new account openings that we're responsible for are inflight and airports, where we believe you get the most attractive customers, and Citi have to do their marketing through direct mail channels, which we believe is less attractive.

JetBlue has been a good deal, and it's running a little bit ahead of schedule. One thing we are very conscious about is the pricing in these transactions. It feels like we're late into a cycle, who knows when we get to the end of it. These are long dated contracts, and if you misprice them you can get locked into pretty poor outcomes for a long period of time. So we're quite cautious in taking on new blocks of business, and we've passed on a lot more than we've bid for.

So even if we don't do any more, the block of business that we've built up should sustain us in terms of revenue potential, but I don't think you'll see us do as many transactions as we've been doing over the last two or three years.

Nothing particular in the jaws. It's the seasoning effect of blocks of business that are really maturing now, and that's why you're seeing a nice squeeze in positive jaws there. It's enough at this stage to offset the J-curve of something like JetBlue or even American where it comes on, because that will cost us time and money to set up a call centre, set up a processing platform before the revenues come in.

It's that constant refuelling of the J-curve, and at the moment that feels like it's got decent momentum.

#### **Sandy Chen, Cenkos**

To follow up on Barclaycard, have you seen any impact from Amazon or PayPal's initiatives in terms of opportunities, final pricing? Then just another question about CIB, or the IB part. I noticed that actually the costs didn't seem to go up as much, and yet the volume increases, the income increases were in the traditionally more expensive bits of the IB. Is there anything we can read into that?

And also, Jes I think had mentioned on the call that there's been a real restructuring towards being much more an agency type business. Is there really an inflexion point in the RWAs that could come about from that, i.e. the Basel IV uplift wouldn't be as great as we might have been assuming?

#### **Tushar Morzaria**

Yes. So on the Amazon and PayPal, the thing on the horizon is this Payment Services Directive 2, which could be an opportunity for us as much as a threat. For those of you that are probably not as familiar with it, when you have the one-click Amazon payment, that's usually connected to your credit card. The Payment Services Directive may allow someone like Amazon to connect directly to your current

account, and pull money out of your current account, almost like an automated direct debit type concept.

That's definitely a threat, and so if Amazon manage to crack the code on that, that could be quite interesting, and it'll dis-intermediate the payment networks. People still leave money in their current accounts, still use their current accounts, but the Visa's and MasterCard's and all them – it's invisible payment, so to speak. It could be an opportunity for us, as it's unclear what data anybody who wants to get into this business, including ourselves, will really have access to. We don't quite know that yet, whether it will be a rich enough, seamless form of data that allows the customer to not even know what's going on behind the scenes, and will they have to start approving or sending some data, although it gets a bit more clunkier.

The other thing we don't really know is customer behaviour about trusting direct access from folks straight into their bank account. It works quite well with direct debits, they're obviously very common and people seem to trust that process very well. We just don't know whether customers will go straight into open access into your bank account, and then authorise that, it remains to be seen.

If it does, then I think there's an opportunity for us. Through our things like PingIt, things like Barclaycard, there's no reason why we can't be the invisible payment provider as well.

PayPal is the same, similar concept, but the other thing is the aggregator business, which Payments Services Directive 2 can allow you to do. [Businesses] like Money Supermarket can collect everybody's bank account information consolidate it for you, and then say, "ooh, I notice you've got a personal loan that you're paying, I can find another bank that can do it for you at 4%." There's no reason why we can't do that, and again, it sort of becomes interesting customer behaviour, will they trust another third party aggregator, or would they prefer to deal with a bank, their own bank, or someone else.

There's no reason why we wouldn't be at the front of the queue for that, because once you become the aggregator it becomes a very sticky business. It's an interesting space for everybody to be in, but there's probably as many questions as there are answers at this stage. And we think that there's a good balance of opportunities and threats for us in this, at this stage. We don't see anything that's something a threat that we don't think we have at least as good an opportunity against.

On the investment bank revenues, [in year] compensation costs is not something that's variable for us this year, so when you say expensive and not expensive, it usually means variable comp, which wouldn't vary, you can't really see that, so it's probably hard to comment on that.

We are more agency-like than some of our peers. I think you see that in our risk-weighted assets already. Market and counterparty credit risk weighted assets tend to be a bit lower than our peers. So therefore I think some of the, for example, fundamentals would be the trading point. I think [with] a lot of inventory on spread products and distressed credit [it] could be more significant. It's probably more manageable for people like us, as a relative matter.

**Peter Toeman, HSBC**

The Non-Core business - £900m of negative revenues this year, within that there's negative funding cost drag. I wondered if you might be able to update us on how you saw that element which might continue into 2017 or 2018, how long it might be panning out?

**Tushar Morzaria**

Good question. So we gave a little bit of guidance earlier on in the year that in derivatives, expect funding costs of mid £30m per quarter, £120m or so [per year], on the size of the derivatives portfolio as it was. Then it's relatively proportional I would say, so now it is a smaller portfolio, the funding cost of carrying that balance sheet will be proportionally lower.

So that's probably the best guidance we can help with at the moment. And we'll try and give – if it's appropriate – more insights into what 2017 will look like on the income side. I know it's quite hard to forecast from outside, and we'll try and be as helpful as we can, but with revenues it will be nearer to the end of the year before we can talk very precisely around that.

Okay. Well, thank you everybody for coming in.

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