Barclays PLC Q2 2016 Results
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Sell-side analyst breakfast transcript (amended in places to improve readability only)

Tushar Morzaria, Group Finance Director

So first and foremost, we have achieved double-digit returns in our Core business and we feel quite good with progress there. We're getting double-digits fairly consistently, with the exception of those quarters in which the bank levy is booked, where we get a one-time dip down. That's important for us because the capital base in the Core is increasing as we release capital from the Non-Core, so that's the convergence of Core dominating the Group's statutory numbers and getting close to that point. So we feel good with progress there, but it's still incredibly important for us to keep consistently rising levels of profitability to absorb the increased capital allocation to the Core, allowing us to book those double-digit returns.

Of course the other side of that ledger is Non-Core, which is continuing to shrink and what's left will ultimately fold back into the Core. We still feel very good about being able to do that by the end of 2017. It's like what you've seen in quarters gone by, sometimes there's a lot of asset sales and leverage or risk-weighted asset reduction and sometimes a lot of M&A type activity on the business disposal front. I would say that Q3 was probably characterised by a lot of M&A activity.

We obviously closed the index business [sale] which was a nice profit for us and we've also announced the sale of our Egypt bank and in the fourth quarter, we should be able to close the Southern European cards business and the Wealth Asia business. It's touch and go whether we'll be able to close Egypt, it may slip into the very early part of the new year as we seek regulatory approval. To be clear, when we book gains on the divestitures of those three businesses it will flow through the other income line.

We did give some sensitivity analysis for Non-Core and there is no change in guidance; we're just showing that foreign exchange rate movements will retranslate the risk weighted assets at the prevailing rates. We tend to hedge our capital ratio for movement in currency rates, so it doesn't really make a difference to our ratio or effective capital.
We want to continue to make progress in achieving our end state capital requirements and continue to accumulate capital every quarter, but as you have seen this is not a linear path.

I feel confident about getting to our end state, which we think should be around 12.5% CET1. Some of that will be through organic capital generation and Q3 was a good example of us achieving this type of capital accretion. Some of that will be through Non-Core, some of that will be through the Africa divestiture, and of course there are a number of headwinds that we need to absorb through all of that.

We want to continue to improve productivity and efficiency. We’ve been talking a lot about costs and up until now we have put out explicit cost guidance, but we will move away from that and focus on the cost: income ratio as a statement of completing the “restructuring” phase of Barclays. We would like to think that once we fold Non-Core back into Core next year then that is the end of the restructuring phase and we’ll move forward from there. Our target is a 60% cost: income ratio at the Group statutory level and we recognise that there's still some way to go in order to achieve this. Core productivity levels are good but we need to improve the Group as a whole. We had positive jaws in the third quarter and in the nine months year to date across all of our businesses. That is an important achievement and we maintain focus on achieving this target.

Finally, we want to put the past behind us in terms of legacy items. We took another charge for PPI in Q3 and this issue should be behind us now, unless new information comes to light. With regards to the ongoing RMBS situation with the Department of Justice (DoJ), I can’t disclose any details about the negotiations.

To recap, our priorities are achieving double-digit returns in the Core, closing Non-Core, getting to our end state capital position, improving our productivity and putting the past behind us. We feel as though we’re making reasonable progress across all of those five priorities.

Andrew Coombs, Citi
You had a very strong net interest margin (NIM) for Q3 in Barclays UK and you're now at 3.63% year-to-date. Your guidance is for the high 350bps for the full year which implies a sharp decline in Q4. Can you elaborate on why you think that there will be such a sharp decline in Q4? Furthermore, what are the implications for next year, as your sensitivity analysis suggests that NIM will be stable or even slightly higher in 2017?

My second question is regarding the investment bank. You had a very strong result in fixed income this quarter, what proportion of the increased income was “one-off” in nature, particularly for credit and rates?
Tushar Morzaria
We guided to NIM being somewhere between 350bps and 360bps [high 350bps] for the full year. There are a number of factors to consider. For example, you get the ebbs and flows of various treasury items and there was a gain that we took on a liability management exercise in Q3. This inflated NIM slightly, so that wouldn't be repeatable and it will dip in the fourth quarter of 2016.

When we had the Bank of England (BoE) base rate cut, we re-priced our assets instantaneously. On the liability side you can't re-price instantaneously, our re-pricing of liabilities takes effect from the 1st December. This lag effect causes some margin compression that we'll see in the fourth quarter.

Nonetheless, we are trying to be very disciplined on pricing in order to preserve NIM, rather than preserving volumes. Next year, the NIM depends where base rates go; if base rates stay at 0.25% we will get a full year effect of the re-pricing on the liability side. If base rates are cut to 0.1%, then we'll be in the 340 - 350bps range depending on when that cut takes effect.

Andrew Coombs
Will you get the majority of the re-pricing benefit to NIM in Q1 with a steady decline thereafter?

Tushar Morzaria
Not necessarily, it also depends on asset pricing. We're trying to preserve NIM where we can, an example of that is mortgage production volumes. Before this year our volumes were higher than our existing stock and we were gaining volume share, whereas this year we've definitely been running under our current stock. We are deliberately losing volume share, but that's done in order to preserve NIM.

On the investment bank sales and trading revenues, these are hard to guide to. Our business model is more of an agency model than many of our peers. When you look at how our revenues behave relative to some of our peers, our correlation to price levels is lower and our correlation to volume levels is higher. So this quarter we didn't really benefit in terms of inventory re-marks, not that there was strong rallying rates or credit. Some of our peers may have done that and good luck to them if they're able to capture that. We probably capture less of that just because the inventory levels we run are much lower but we do benefit a lot from our volumes.

In the nine months year-to-date that has worked out quite well for us. Where there's been activity we seem to be getting more than our fair share, which is pleasing. Repositioning the investment bank has been difficult but we’re beginning to see some of the results really coming through now, particularly in things like credit trading where there's been quite a reasonable turnaround. With macro, my view is that
given the restructuring that we've thrown at that, it has held up incredibly well and actually finished its restructuring much before credit did. So in some ways people forget about how much capital we took out of the macro business.

It is a cyclical business and therefore it's very hard to give precise guidance, but when markets have decent flow volumes we will do fine. Where we won't do so well, relative to our peers, is if there's a big rally in asset prices that isn't accompanied by a healthy level of volumes, then you'll see peers outperforming us. But on the flip side, if you see a big decline in asset prices not accompanied by volumes we'll probably be hurt a bit less than our peers. And I think Q1 and Q2 are probably interesting examples of that, where we've probably been hurt a bit less than peers in Q1 but we probably didn't benefit as much as peers in Q2. This was due to the movement in inventory levels where we're not really exposed as much.

**Martin Leitgeb, Goldman Sachs**

As a result of the EU referendum there are challenges such as passporting, the current lower rate environment and potential increases in costs. Could you give more detail on this? Secondly, have you received a settlement offer from the DoJ regarding the RMBS case, could you provide us with an update on progress?

**Tushar Morzaria**

With regards to the EU referendum, reorganising our operations is something that we'd prefer not to have to do. But any reorganisation would not be anything like the scale of what we had to do in the United States for CCAR preparedness, or even in the United Kingdom for ring-fencing our UK operations. Nonetheless, it's real work we need to do, real licences we'll need to re-invoke, real models we'll have to get improved, real people we'll have to move around.

The levelling factor is of course this one isn't unique for us, whereas the combination of the other two was somewhat unique to us. The advantage we have is that we have a permissioned bank already in Ireland. It's pretty small and currently does some corporate banking, but it will need to be restarted and reactivated in terms of permissions that we've already got for a more holistic business. So I think we have a good starting block and we have other choices in Continental Europe to the extent we can take advantage of them, which we are exploring and discussing with local regulators. It is definitely unhelpful and disruptive and we'd rather not do it, but it is manageable and very equalising.

The macro economy is interesting, particularly in the UK, and a harder one to call. If you look at our spot data, it looks remarkably resilient. We're actually seeing delinquency trends get a little bit better in Q3 versus Q2. It is a spot measure and as a management team we are very cautious going into next year.
and we're not assuming the economy will stay as robust as it has done. It's tough to predict what will happen to the economy, if it were to dip into recession that's definitely going to be a challenge.

I think we're slightly more conservative in our risk position than some of our peers. We'll know for sure if we do go into an economic slowdown. From everything I can tell that so far we would relatively do okay in a slowdown, but time will tell. We're assuming that we don't get passporting rights and we have to plan on that basis because by the time you find out whether you've got passporting rights or not, it's just too late. I think all banks will be doing the same, we'll do everything we can to try and get a good deal for the United Kingdom and London but we're not banking on that happening.

On the DoJ investigation, there's not a lot I can say. You're probably referring to the Bloomberg article that came out recently, which we put out a reasonably strong statement through our spokesperson that that article had numerous inaccuracies. Our real view here is that speculation is unhelpful for everyone. Unfortunately, newspapers have a job to do and love reporting this stock but it's actually unhelpful for everybody involved in the discussions to have this speculation going on and the rumour mill starts creating expectations and forcing people to take positions. I'm not going to comment on it anymore apart from that it's important, we'd love to get it behind us and we're working as expeditiously as we can with the DoJ to do that, but not at any cost.

Peter Toeman, HSBC
A peer recently discussed the PRA review of mortgage risk-weights, could you discuss how this would impact Barclays?

Tushar Morzaria
We haven't talked so much about this for a couple of reasons. It's still in consultation, but to cover what the PRA said in the review is that their expectation for banks with the kind of model we have, a through-the-cycle model, will be less impacted than banks for mortgage risk weights that are on a point-in-time model. That remains to be seen.

When we compare ourselves to other large UK peers, our average risk weight is at the higher end, so that again makes me think as a relative manner, we're probably less impacted, particularly given the profile of our book. I don't think we've got higher risk weights because we're in a different part of the credit spectrum. We'll see what comes out of it, but from what we understand today it's not something that I felt concerning enough to call out for our numbers. That might change, but that's where we are today.
Fiona Swaffield, RBC

My question is regarding the 100bps of capital accretion for the BAGL selldown and Non-Core disposals. I know you don’t want to say how much of the 100bps is from Non-Core, but I would like to try to understand what you may have assumed on the cost of closing Non-Core, because there is still another £16-19 million to close, depending on currency. Is there any assumption on that in the 100bps. How do we think about Q4? Could it be that we get a big charge on revenues, the way you’ve guided, but then there is a delay in the derivatives take out?

Tushar Morzaria

Yes, on the second question, usually for derivatives there’s not much of a lag. These don’t have an M&A process where we have an announcement and then a deal that we have to take a provision on. It tends to be very synchronised, so if we take negative income it will be reflected in our balance sheet. You might get some quirky stuff, but I’m not expecting it between trade dates and settlement dates across the year end, that will only be very technical effects. Generally speaking they’ll go together.

We have our own views on estimating what the exit cost will be to drive down risk weighted assets. We put that into our models, projections and forecasts and that’s how we get comfortable with our capital trajectory. There is a degree of uncertainty around that, particularly when you’re trying to look at a 12-month forward horizon of derivative transactions and the vagaries of markets and counterparties.

Thus far, it’s gone according to plan, helped by markets having been quite orderly. We had a few wobbles earlier this year but they were quite temporary in nature and didn’t really affect us too much. If markets stay orderly as they have been, as long as there’s good liquidity, then we should be able to get through and meet the capital guidance that we’ve disclosed. But it’s very difficult for us to be precise, because there’s just too much of a range of outcomes.

Not everything will go exactly according to plan, but you can make up for it elsewhere. There have been some businesses that we’ve sold at a higher profit than we thought we would and some derivatives RWAs that got out at a better level than we thought.

Chira Barua, Bernstein

We see a lot of currency and rates volatility, could you give us a broad view on how the bank is hedged on capital, potential outflows and the Non-Core disposals - just around currencies, also the production the equity had, where do you stand right now?

You’re putting out your Intermediate Holding Company (IHC) P&L and balance sheet in November and I have three questions on this. What part of your US business actually goes through the IHC and what part of the securities business that doesn’t go through branches? Secondly, following up on the double
leverage that you've been discussing with the PRA, is there any update around that. Thirdly, is there an LCR liquidity trap? UBS pointed to a loss in the liquidity coverage ratio through the IHC, I just want to understand your 125%, is it going to come down once you get the IHC set up?

Tushar Morzaria
We have been hedging currency volatility for some time and will continue to hedge for our CET1 ratio for currency effects. The way we do that is by holding an amount of local currency capital, supporting local currency risk weights in appropriate proportion. The big move that we've seen in Dollar and Euro strength relative to Sterling had a very modest effect on our capital ratio. These were gigantic moves, so for small moves it will have no effect.

We used to do the same for Rand but we have switched that to hedging book value because now we're in a divestiture process. At some point for the company, and this is going several years out, I think it makes more sense to hedge the book value of the company; you want to compound and grow the book value of the company and not have that bounce around through currency effects. That's probably one for another time. But we're relatively neutral to currency moves for our capital ratio, our CET1 ratio.

Our equity structural hedge hasn't really changed. We have been running a hedge for several years and it's been quite profitable in this rates cycle, as we've been able to preserve higher levels of NIM than we otherwise would have done had we not had the hedge in place. We are continuing to roll that hedge, so we're not taking views on the rates market by changing the duration or lifting hedges. We think of it as much more of a smoothing mechanism for income and it has been incredibly profitable.

You can see last year we booked around a £1.5 billion net structural hedge contribution. It will be roughly the same again this year. Clearly rates have had a dip and then backed up again, so they'll be financing to the appropriate level. If there is a very sharp back up in yields that will delay the transmission effect of picking up that income, but that's something we're very comfortable with.

On the IHC, you can get a pretty good preview of what this will look like because the two largest parts of the IHC have already published the numbers. You have the Barclays Bank Delaware in Wilmington which is our card operation, and you have Barclays Capital Incorporated which is our broker-dealer. If you add those two together, you virtually have the IHC. There's not much else apart from some very small constituents, but you've got the 80/20 rule there. What isn't included under the IHC is our branch and that's true for everybody else of course. Our branch has our derivatives trading activity and our lending activity in there. If you wanted to see the liquidity coverage ratio, if you look at those two published set of accounts you'll get a pretty good sense.
In terms of double leverage, we are waiting for the consultation paper from the PRA. They may regulate double leverage in a way that it isn't regulated in the US, it remains to be seen. The bank holding company structure in the UK is quite a new concept for them, unlike the US where it's been around for quite some time. My experience of working in a US bank is that the ratings agencies and investors tend to regulate it for you. Some banks have very high double leverage – Wells Fargo will probably have one of the higher forms of double leverage, and some are very low.

We'll see what the PRA does. I don't think we'll be aggressive users of double leverage even if we had a free rein. Again, this is just for the prudential management of the company. There will already be a form of structural subordination; that's just as a concept of TLAC which forces you to downstream in structurally subordinated form. So there will in some ways be some double leverage by statute which the Bank of England's resolution process forces you to do. And that's kind of a shallow form of double leverage because it's sort of senior to senior.

Could we do some AT1 to equity - possibly; would you do senior to equity? I can't imagine that happening. So I currently don't think double leverage will be the stuff that people think i.e. senior to equity. But very subtle forms of double leverage like senior to senior, that will happen, but we'll see what the PRA say on that. My sense is that over time it probably will revert and it may take some time, to a US model where the market will probably regulate it for everyone and put a cap on that.

**Chira Barua**
Do you have visibility right now on the capital rules and the supplementary leverage ratio for the IHC?

**Tushar Morzaria**
Yes, you’ve got to be compliant with full bank holding company rules and regulations in the US. We have total visibility on what the capital requirements, NSFR, LCR, everything will be. And Tier 1 leverage, supplementary leverage – the full works. There's nothing we get a pass on.

With LCR, we’ll be required to report a consolidated liquidity coverage ratio at the Barclays PLC level. That will remain as is. We have got an end state capital march that we’ve been on, but we haven’t really been on an end state liquidity march. We’re abundantly liquid already. Our consolidated LCR is 125%, one of the highest in the industry. We deliberately ran it higher through the Brexit vote, some of you have noticed that in our liquidity pool we had much more cashed in securities, and that was a very deliberate choice.

There are some quirky effects in LCR. For example, liquidity raised by the card company can only be counted for that entity’s liquidity purposes; you can’t use that to say you’ve got a liquid broker-dealer.
So there are those very technical effects going on, but I don’t think we’ll be publishing a lower LCR as a consequence of that.

Michael Helsby, Bank of America Merrill Lynch

My first question is on the property transaction closure or shrinkage. Clearly, given Jes’ remarks, it’s quite a big deal for you. So I was wondering if you could translate how much that actually saves in Sterling for us next year or the year after if there’s a delay.

Second one is picking up on remarks about moving away from absolute cost guidance and moving to reporting a cost: income ratio. Jes alluded to a lot more investment than people have got in mind, so I was hoping you could join it all together, relative to consensus, which has still got Core costs falling next year by about £150 million, does that still look sensible given the movement in the Dollar?

Finally my last question is on ring-fencing and MREL. In the past you’ve talked about the move to ring-fencing as being neutral from a funding point of view because of expenses rolling off. I was wondering if you could extend that now to full adoption of MREL, do you think that would be neutral or whether you think there’s a big tailwind as you go out further in duration.

Tushar Morzaria

As you know, we took a £150 million real estate charge. We didn’t quote the run rate benefit, but generally with real estate they are not the most ROE accretive actions you take.

Take branch closures for example, if we have a branch on a 20-year lease it’s almost uneconomical to close that branch because the charge-off is so large. It takes so long to pay back that you’d rather do something else. So there is a slightly peculiar situation where you keep a branch like that open and as soon as it gets to, say, within seven years of end of the lease it starts to get interesting. As a result, the rolling closure of branches is driven mainly by the lease length than anything else.

So this property charge, it’s not going to score any high levels in terms of ROE accretion, but it does a couple of things that are really important for us. Again, if we believe we’re in a slightly less buoyant UK market, then it’s a good time to be exiting real estate when you can. There may be an oversupply coming on to the market, we’ll see. It does have a forcing mechanism also in our other productivity measures. So if you’re closing London office space rather than branches, £150 million is a truckload of London office space. Not having that space anymore will force us to execute on plans we already have in place to have our staff relocate elsewhere. We have started this in Manchester and Glasgow, which are some of our large processing centres.
So it’s actually the peripheral benefits that are as interesting as the actual run rate real estate saves. And they can be quite significant. We have about two million square feet in Canary Wharf, if you could reduce that by 500,000 square feet then the peripheral benefits of having those colleagues working elsewhere into perpetuity would be considerable, but that takes time to execute.

In terms of cost guidance, it sort of links in quite nicely. One of the things that Jes has successfully done is to wean the company off costs-to-achieve (CTA), restructuring charges, structural reform programme costs and anything else that people want to pass on that the group head office seems to underwrite. Everybody needs to pay for their own stuff now.

So this real estate charge was in the Corporate and Investment Bank (CIB) and we didn’t put it below the line or adjust for it. The CIB have to pay for it and they have to pay for it within their cost guidance, within our £13 billion currency adjusted cost guidance.

So going into next year, Jes is definitely of the view that there are areas of the bank that we do need to invest in, particularly around some of the technology areas, and it’s away from the processing architecture where we spent a lot of time, it’s on more basic infrastructure. So we will do that, but the investments won’t receive specific funding, it must be done within the business’ current capacity. I think that’s a very good discipline that Jes has managed to instil into the company. When we do business reviews, we don’t talk about CTAs or structural reform. The businesses have their own cost in which they must find their own capacity.

This is the same for severance charges, as we’re moving these thousands of people out of central London to other locations, these costs will be included in the business’ current cost objectives. There’s no pass for that.

In terms of guidance in absolute pound levels into next year, I’m not going to guide to that. We’ll stick to trying to be helpful where we can to give you a flavour of where we think we’ll end up on a rolling basis. We will be looking much more at cost: income ratio and progress against that rather than absolute cost.

I would say, however, that the march on cost is definitely flat to down. You won’t see us materially increase our cost base unless we see top line opportunities that we’re not currently anticipating. So the discipline and the focus on driving down or improving operating leverage through managing that cost number is as high as it has ever been, but we won’t be explicit about forward guidance.

Andrew Coombs
Is this “flat to down” excluding FX?
Tushar Morzaria

Yes, like for like. We like a strong Dollar, as you know.

On funding costs and ring-fencing, it’s difficult to be absolutely certain. Everything that we’ve done thus far has worked out well in terms of funding. These are still very attractive funding rates and we’ll continue to issue opportunistically as much as is sensible in these kind of markets - and they are very attractive markets. We will look back in years to come and say that these were very attractive funding rates and we’ll lock in as much as we can and we have some expenses rolling off. I think in the mix I would still say it’s neutral. You know, we’re probably carrying more wholesale funding net-net than we would’ve otherwise done in a non-MREL world. But I don’t think that’ll be a very significant cost.

I think if rates stay this low into an extended period of time, it may start turning into a tailwind. If you can go through another round of refinancing and start locking into seven-year rates at these levels, I think that starts looking really attractive, but we’re in the first round of financing and I think you have to go through another round to really make that case.

Chris Manners, Morgan Stanley

Morning, Tushar. I’ve got a few questions, if I may. The first one was on the Equities business. The rest of your Investment Bank is doing pretty well. Equities is running with revenues minus 13% year-on-year, despite some Dollar tailwind. Could you maybe give us a sense of what the underlying run rate is there? Because I know obviously you have had business closures, and want to know whether you’re actually profitable in Equities and how you think about that business.

The second one was on costs more broadly in CIB. On the nine-month run rate, you’ve got a 66% cost:income ratio. Obviously, that’s a big chunk of the Group, and you’re going to need to get those costs down or revenues up. What initiatives do you have there - maybe you could be a bit more specific on what you’re doing there?

And the last one was on Barclays UK and the loan to deposit ratio. Six quarters ago you had a 98% LDR. You’re down at 90% now. Are you going to start to lend a little bit more? Because you’ve been a little bit more defensive than some banks in terms of posture in the mortgage market. Thanks.

Tushar Morzaria

Thanks Chris. On Equities, I think you’re right to point out that we’re not doing as well in Equities as we have done in other parts of our investment banking business. In fact, the other line items, Debt Capital Markets, Macro, Sales and Trading, Credit, even M&A, have actually performed pretty well.
I think in Equities, one of the things that, when we look back, we’re probably underweight as a consequence of our deleveraging, is probably in equity financing. And when I look at how other peers have performed – and where you work is a great example where you have a very good equity financing business – what it does is it provides a really good stabiliser to the volatility of the sales and trading line. So in other banks, I think they’re just more predictable in terms of their Equities print because their financing business is more developed and a larger proportion than we have.

I think part of that was probably, as I say, driven by our desire to deleverage. And financing businesses are easier ones to deleverage, as they are leverage heavy, quite frankly. So something we’re looking at. These aren’t risk weighted assets heavy businesses. But you won’t see us increase leverage either. But that mix in that Equities business is something we’ll look at.

Where we have done well is US cash equities, where we think we’ve done as well as anybody else in terms of market share. So there are some really good parts. I think the financing business just exposes some of the volatility of that.

In terms of underlying run rate, again I’d go back to the question on sales and trading. I’m not a big fan of guiding to that.

Chris Manners
Have you taken enough cost out of the Equities business with the actions that you took to mean that in your projections, it’s actually making a decent return?

Tushar Morzaria
Yes, absolutely. We’ve managed it for returns. But I do think that when you’re less leverage constrained, your returns can be dramatically improved by a good financing business because it doesn’t consume much. If your constraint is Common Equity Tier 1 capital, it’s hyper efficient from that perspective and it’s a very stable form of revenues. So that’s where I think we could potentially look at it again. But we’ll have to do it within the constraints we set for ourselves. So no more leverage and no more capital, we’ll have to find room for it. But it is a profitable business, yes, and we’ve designed it to be profitable.

In terms of where else costs continue to come down from, I think it’s one of these things that we’ll probably have the same response to into perpetuity. It’s still looking at people, it’s still looking at real estate, it’s still looking at technology, and those are our three biggest areas of costs. Every bank has those three big areas of costs.

We’ve talked a little bit about real estate. We’ll continue to reposition our real estate where we can. A lot of that stuff we never really call out. It’s constantly going on. But I do think we potentially have maybe a
bit more of an opportunity because I think we’re still too London-centric. I think we have one of the bigger footprints in Central London, relative to our peers. It doesn’t feel very necessary so there may be opportunities there.

We’re just going to have to take one charge to help do that and that will have the halo effects of people moving out as well, which has all sorts of tangential benefits. You get less turnover, more stable workforce, more loyalty and many other positives. But it’s a march to do that. These things don’t happen overnight.

On the technology side, it’s full steam ahead on continuing to streamline our infrastructure. A lot of that’s been going on and will continue to go on in our wholesale businesses. But even in our retail businesses, by bringing card and retail together, we still have two fraud departments, for example, two collections departments, two call centre strategies etc. And all of these things have worked quite well. I mean, both those businesses have quite reasonable cost: income ratios but the opportunity for that is still pretty high.

In some ways, the Barclaycard business and the UK retail bank have been run very side-by-side, and they’ve competed in some ways against each other, quite deliberately. If you look at, say, mobile payments, we’ve got PingIt in retail and we’ve got bPay in Barclaycard, and they’re literally competing, and that’s good forms of competition. We like to make more than one bet, so to speak, and see which one works better.

But I think there are opportunities behind the scenes. Particularly if we go into a less buoyant UK market. For example, if you need to ramp up in collections as the best way to manage credit risk – well, that’s a real opportunity set for us. Fraud is another good opportunity set for us as well. So I think you’ll see not just technology in the traditional parts of the wholesale banking – and we’ve still got a lot of work to do – but in the whole of the company.

So more of the same, I would say, and it’s probably into perpetuity, quite frankly. I think we’re mature as an industry, we’re very mature now. Banks used to be growth stocks. I’m not sure we’re going to see that anytime soon. So it’s a different way of running it.

In terms of the loan to deposit ratio in Barclays UK, yes, you’re right. We’re well cash funded, we’re cash rich. I wouldn’t say we’re capital poor, but I wouldn’t say we’re capital rich. So that comes into the mix. So looking to put that cash to work in very low risk weights is attractive, and that’s somewhat driven by our credit appetite but also somewhat driven by our capital capacity as to the kind of business that we write.
And it suits us well because we’ve never been into the dense risk weighting, lending-type activities anyway. We feel we’re quite late in the cycle and now is not the time. We’d rather have the excess cash than think about buy-to-let or something like that. And that’ll be a call. We’ll find out if that’s right or wrong.

But somewhere around 90% probably feels about right. I think if it starts getting much lower than that, we’ll look for other opportunities to just float that cash up. I don’t think you’ll see us go back up to 100% or even above 100%. I know some of the banks do.

I think part of that is driven probably by just our view of where we are in the cycle. I think we’ll just stay a little bit closer to home. And part of it will be, the easiest way to put that money to work will probably be in higher risk weighted activities. And so that goes back to our view of macro. We’ll probably be a bit cautious there.

**Chris Manners**
But if you keep growing deposits at the rate you’re growing them, and held the LDR flat, then you’re going to have to step up the lending rate in Barclays UK anyway.

**Tushar Morzaria**
Yes, but in the low risk weighted parts of lending. For example, we’re very underweight in buy-to-let, we’re very underweight in first-time buyers, we’re very underweight in interest-rate-only, and you could go aggressive in those. But that’s probably what we wouldn’t do. So we’d look for low risk weighted activity and that just suits our credit style. But it’s not easy to do. There are so many people that want those kind of mortgages, but that’s where we’ll probably play harder if we need to.

**David Lock, Deutsche Bank**
I’ve got three questions, please. The first one’s coming back to the question on hedging. And I know your capital hedged from the CET1 perspective, but I wondered if the AT1 was hedged? And I guess, as part of that as well, how much of your RWAs are in non-Sterling and how does that compare with the AT1? Because do we need to therefore perhaps see more Sterling AT1 issuance than we might have had previously?

Secondly, just turning to PSD2, I wonder if you could give any colour or views on how you see that as an opportunity or a threat for Barclays?
Tushar Morzaria

On AT1, we don’t hedge our leverage ratio. So in that sense, we don’t try to match our tier one capital currency to leverage exposure, because you can only really run one form of currency hedge. We hedge CET1. So we do have some exposure to fluctuation in currency for our leverage ratio.

It’s not that significant, and you will have seen, again, if there was a big move in our leverage ratio as a consequence of a fairly dramatic move on Sterling, we would have called it out. So it’s been more manageable, and the leverage ratio is obviously smaller than the CET1 ratio. Also our leverage ratios are way above any requirement so I’m quite happy to let that volatility run through. For P&L purposes we don’t hedge the AT1, so if we have, for example, Dollar AT1 that we’ve issued when Sterling is weak, that will be expensive for us, so that’s something that we’re mindful of.

The issuance of AT1 though, the Sterling AT1 market is very small so even if we wanted to issue everything in Sterling there’s no way you could do it; you would have to issue in Euro and Dollars and swap it back if that’s what you wanted in terms of currency mix. And also the vast majority are issuers in non-Sterling. We did a Sterling AT1 issuance last year, and that went really well, but it’s still a small part of our overall issuance. We’d love to issue more Sterling; it’s one of the things that we’ve talked to the regulator about, that with the amount of paper the banks need to issue, the Sterling market just isn’t deep enough to absorb that, so we’re going to be quite frequent issuers in Euros.

PSD2, it’s an opportunity and a threat, no doubt about it. There’s going to be a lot of Fintech companies, a lot of aggregators – the Amazons of this world, they’re going to absolutely try and use this as a way of getting in front of the banks, trying to make it virtually invisible, which bank you’re using.

And likewise I think there is an opportunity for us; the one thing that’s still noticeable within customer behaviour is that although banks are still the villains in the play, there’s still a trust in terms of allowing a third party to see your financial information. It’s still quite interesting how nervous customers are on that, and so in that sense banks still have a high degree of trust, that I’d rather this information stay just with my bank than sharing it around.

So I think there is an opportunity there as well for banks, not just us. We’ve got one business that I think is quite unique compared to some of the larger players, which is our open market card business, Barclaycard. The trust levels are quite high in a brand like that, and that is an opportunity where they may feel more comfortable sharing if you bank at NatWest or wherever you do, sharing your data elsewhere.

And there’s no reason why we can’t be an aggregator either, just the same way as Fintech companies can. We run hubs called ‘Rises’ where we incubate small Fintech companies. Some are looking to crack
the code of trying to cannibalise our own business. So it's definitely a threat as well as a potential opportunity. And also there's still a way to go; I think exactly what information protocols and what information will be available and how available it will be is still unclear yet, so still much to come on that.

David Lock
Do you have what split of RWAs are in Sterling?

Tushar Morzaria
We haven't given a currency split, no.

Raul Sinha, JP Morgan
Can I ask three questions, please, Tushar. The first one is on the G-SIB buffer; hopefully sometime in the next two weeks we should have some updates on that. Just a question of if you were to see a drop in your G-SIB buffer, will that then impact your systemic reference points for this year's stress test, the one that's released on 20th November?

Tushar Morzaria
So the jumping off point is 31st December 2015. If we were to go down a G-SIB buffer – who knows whether we will or not – technically it doesn't come into effect until two years in the future, so it will be, I think, 2018 that comes into effect. Having said that, it depends on what the low point of the stress test is. But it won't affect the 2015 stress test, it will affect the 2016 stress test. So it won't help us, if you like, in the one we've just taken, it will help us in next year's one.

Raul Sinha
The next question is on Africa; obviously there's some commentary about the PRA clarifying a 20% limit in financial investments as a de-consolidation point for capital. I wonder if you can comment on that? And what do we need to see for you to actually take the next step on Africa? Are you waiting for the TSA to be signed and approved with the local entities? What can we see from the outside that will help us get a sense of that? Because I don't think the lock-up matters any more. From what I understand, it's more when you're ready to start selling.

The final question is on Barclaycard US, if I can. I get that the delinquency rate is going down in the UK, but in the US obviously they are going up. We can see CRLs are 3.7% [in Barclays International], compared to 1.4% in [Barclays] UK, it's a much higher number. Obviously that's a book where you have acquired in the past as well, so if you can talk a little bit about what asset quality you expect there, that would be really useful.
Tushar Morzaria

On Africa, the 20%, it's a very qualitative test for de-consolidation. The only numeric test that's codified is that it's got to be below 20%. I don't think at 19.9% that we'd de-consolidate, I think it will have to be below that. I would expect below 15%, I think somewhere around between 10% and 15% there's a real strong case. But somewhere around there you can make a very strong qualitative case that you're not a reference shareholder and you wouldn't be back-stopping the company etc. But I think 19% is not going to fly – I think it's too big a stake in a very important systemic institution. Unless there's another shareholder that has that quantum of shareholding that are considered reference, I think you'll probably still end up, as a PRA matter, consolidating. But at below 15%, I think there's a good case to be made.

What will happen is I think under PRA rules, below 15% you get to a 250% risk weight, and below 10% you get to a 150% risk weight; because that's codified I think that gives you a clue. And when we looked at RBS and Citizen's, I think it was around mid-teens or something that they needed to get to as well, so that's what we're thinking.

In terms of the process from here, there are basically two ways you could do this. Let me take one step back; we do need South African Reserve Bank (SARB) approval, and possibly government approval, to become a non-controlling shareholder. SARB approval is required regardless, that's just the law down there. Government approval if there's a strategic buyer, simply because it's a pillar bank and they want to know who's systemically involved in their banking system. If it's not a systemic bank, then it's local institutions for whom they won't need to give approval and probably won't be interested in giving approval if it's local institutions.

So that's one thing; now you can do this one of two ways, you can agree a Transitional Services Agreement (TSA), a separation agreement really. For a separation agreement, that's important to allow Barclays Africa Group Limited to survive by itself operationally. [We need to] lodge that, get approval that it's an approved plan, and then sell shares. Or you could separate first and then ask for approval to sell shares. We'll almost certainly do the former, and typically every M&A exercise that you've seen us do in Non-Core has been the former; so our Iberian cards business, our sale of our Egyptian banking business, our Asian wealth business. For all of these you agree a TSA with your regulator and your purchaser, or then the local management team, and you sell shares. And the TSA agreement carries on until you close the transaction, and sometimes it goes beyond the closure of the transaction, depending on the nature of the agreement. Bloomberg is a good example; even the sale of the Index business had exactly that same construct, and that wasn't even in a subsidiary so it was sort of hiving and creating a subsidiary to sell that business out of. So that's typical M&A. There's nothing in that sense very unique about this, just the size, and that's why people are more interested in it. But otherwise it's just standard practice M&A.
We will almost certainly want to lodge TSA approval with the SARB, and once we've agreed it with the management team, at that point, once we're approved, we'll be free to transact. Probably, once we get freedom to transact, and I don't know this for sure, we'll have lawyers look into this at the right time, but that may be disclosable at that point, by both sides. But that's probably the first time you'll hear about that. We've always said this will take two to three years, and the reason is because it's going to take that long to run the Transitional Services Agreement, and that's why we've always guided toward that timeline.

So in that sense everything is going right according to plan, but it will take two to three years and you'll probably hear about the TSA at some point next year. That probably won't drift into 2018, and at that point you'll have a pretty good sense of when the deal will close and what the capital benefit is to us, and that will obviously depend on the deal value.

All exit costs, all transition costs, are included in the capital guidance that we gave you, as best as we could estimate it, obviously. Everything is in there, as best as we can estimate it. I don't know what the Rand share price will be, and the Rand rate, and I don't know with a degree of precision what the Transitional Services Agreement we'll negotiate, but within the range of values that's included in that.

Card delinquencies, so in the UK while delinquency has dropped, in the US, as you say, on our numbers they look like they've picked up a bit. They didn't really pick up, what happened was our business mix changed. The most super prime part of our portfolio is the American Airlines, or was the US Airways, card portfolio, and when we got into negotiations with American, and I guess a three-way negotiation with Citibank, we stopped originating new cards, and that stopped at the back end of last year. So you still get seasoning and P&L from the cards you'd already generated, but we're not adding any new ones on there. Because of that, and we're growing other parts of the book, you just get a shift in mix because that was the single most prime, super, super prime part of our book, so anything else is going to be less prime than that. And therefore, as a blended matter, it looks like your delinquencies have picked up when in actual fact nothing has really changed. It's just your mix has changed. Underlying that, we did notice a couple of US banks, including Chase actually, called out that they were seeing a little bit of a pick-up; if you look hard at the data, you wouldn't be able to see anything, but if you look really hard, that is what we see as well. It's very small though.

If it was a real pick-up, we would have probably given you a number or something like that. It's very early signs. It's intriguing because it's the opposite of what I thought; I look at that risk department and say that I thought UK was going to get worse, how come the US is? And we're seeing if this is something that really is a trend or not, but it's interesting that other US banks called it out a little bit as well. It's not of a concerning nature; I think if it was we'd all be calling it out and you'll see provision
increases and whatever else, so I don't think it's that, but it's an interesting thing that we've all noticed in our data, and we'll continue to monitor it really closely.

And regarding the UK; if anything the UK is also as perplexing, in some ways, as the US. I would not have expected UK delinquencies to improve, quite frankly, so we'll watch that really closely as to whether that's a slightly weird blip as well. Maybe there's a sort of a symmetrical blip going on there, but it tells us there's just one more reason for us to be a little bit cautious, I think.

James Invine, Soc Gen
Hi, good morning. I've got a couple of questions please, the first of which is on Africa. Are you going to retain a stake in the business because you always talk about taking it below the de-consolidation levels, but I don't think I've ever heard you quite say you're going to zero? And then the second on is on Non-Core, if you could just remind us, please, the funding costs that you charge to that division. Thanks.

Tushar Morzaria
So for Africa, our idea is that we prefer not to, but there's no way we can sell half of a company without having some skin in the game. So whether it's a capital markets transaction or a strategic buyer, the expectation will be that we will have to retain some sort of rump stake. How long for, who knows? Our objective is to de-consolidate, so it will be small enough, and any purchaser knows that we won't own more. If it triggers any form of consolidation then the deal's off. We'll have to own something, I think, just skin in the game.

James Invine
And that's just a staging post?

Tushar Morzaria
Yes, and it depends if it's a strategic buyer, they may want us to hold it for a period of time while you'd expect some lock-up or something like that. If it's local institutions, capital markets, there will probably still be an expectation, probably a shorter lock-up, but some form of lock-up I would imagine, standard M&A practice I think.

Regarding funding costs in Non-Core, in that sense that we obviously allocate our funding according to the assets in Non-Core as we do to our Core. The two that I've called out in the past are the funding costs of the ESHLA portfolio and the derivatives portfolio, respectively each about £30 to £40 million each per quarter. I think I called it out in the first quarter, so it will change, obviously, as the size of the book decreases, but if you go back to first quarter rates I think about £30 to 40 million each for the size of those respective portfolios as they were in the first quarter gives you a sense of what to expect.
James Invine
What about the other assets? If you take the total asset number, you can take away the derivatives and loans...

Tushar Morzaria
Yes, you've got some Italian mortgages in there and that's really about it in terms of heavy assets if you like. Then you've got businesses, so really there's not much else left in Non-Core; the rump of derivatives, Italian mortgages, very small number of other loans and securities, but really small, and then the ESHLA book.

Sandy Chen, Cenkos
Just maybe a left field question, but with Trump pulling ahead and looking at liquidity and counterparty risk particularly, do you see any liquidity and counterparty risk issues in the Central Counterparty Clearing [CCP] market? For example, similar to what happened during the Brexit vote, and what kind of potential non-interest income implications that might have? Thinking about what happened during the margin calls, intraday liquidity calls with CCPs and how that might be affected.

Tushar Morzaria
We're not a big fan of the CCP model; we like some, we like others less. We like London Clearing House risk management framework a lot, not as thrilled by the way the CME do it. But having said that, I don't think they're vulnerable to a “Wednesday morning” problem. The amount of guarantee funds and the amount of initial margin that's called these days is quite something. The reason why we don't like the CME as much is the form of collateral that they're prepared to accept is of lower quality than I think we would prefer. And we like the London Clearing House because it's a more mutual ownership model where we all sit on the risk management committee and can insist on the form of collateral that's posted, whereas the CME is a publicly traded company and we're not allowed to dictate the risk management, and they have a very thin equity base. So the model we don't like as much, but I don't worry about Wednesday morning [post US elections] and wondering if the CME or ICE or something like that has collapsed. I hope I'm right in that, but that's our base assumption.

The good thing in a year like this is that there's been a lot of stressed moments; Brexit was a good one, and even at the beginning of the year the AT1 market was shot for virtually all European banks in February, March, and we were wondering if we could ever issue again. And then it opened up. So those are quite stressful events in terms of managing liquidity and managing collateral flows. A good example of a collateral stress we went through was at Brexit. One of the things that was very interesting for us was the asymmetry between those counterparties that don't post collateral and those hedges where we are collateral posting and want liquidity alpha. It was a real life stress on an event that we, although we planned for, really didn't expect to happen. So I think in that sense the system's had a good road test. I
guess anything could happen, of course, so never say never, but I think the industry is in reasonable shape for a wild Wednesday if that's what transpires, yes.

Sandy Chen
Partly expecting you to say as well, given that you operate more of an agency model nowadays.

Tushar Morzaria
That's true as well, yes, but nonetheless it's not like we carry zero inventory; that's something we've got to watch real carefully. But I think we feel okay with it, everything we've seen thus far.

Chintan Joshi, Mediobanca
Hi, good morning. Can I pick up on a few things? So firstly your mortgage strategy; just picking up on Chris's question, your loan deposit ratio is now 90% and you're looking to be there. And if I think about somebody in a similar space as yourselves, one of your peers has grown quite aggressively [in the mortgage space]; their flow is 12% compared to an 8% back book share, but you haven't done that. Are the economics there to do that if you want to? I'm just wondering what stopped you, and is that 90% being achieved helping you to get more aggressive again?

Tushar Morzaria
One of our larger peers has definitely noticeably changed their behaviour in places like buy to let, very noticeable, which is quite surprising actually for a bank that traditionally didn't play in that space. It's been very visible how they've ramped up. I think for us, everybody has their own views of what they want to do and how they want to do it, we're a little bit cautious.

There are parts of the credit spectrum we like, we're comfortable doing, and there are other parts of the credit spectrum we don't want to be experimenting in now, and that's a call that we'll see if we're right or wrong. We may be leaving money on the table, we may have called it right, but that is our view. So in terms of that 10%, 15% of available cash to reinvest, I just don't think you'll see us drive that into risk weight such that our LDR doesn't even have to be high risk weighted. I just don't think you'll see us be as aggressive in terms of going after volume share that one of our peers, at least, appears to be doing late cycle and on business we just don't want to experiment on now.

Chintan Joshi
The other question was on PPI; roughly £250 million [utilisation] this quarter, if I work backwards. If I use that run rate, you still need about half a billion, six hundred million more [of additional provisions]. The assumptions baked [into the existing provision] imply almost a 25% year on year reduction [in claims]?
Tushar Morzaria
Not quite like that; you've got some remediation work in our run rate that drops off, so the flow, the reactive element coming in is much lower.

Chintan Joshi
What is the assumption there of reduction in reactive complaints?

Tushar Morzaria
I'm not going to give you a number, but to help you think through how we work it through, we look on experienced volumes, project them out based on our estimate of customer behaviour and make sure we're adequately provided. In the numbers there are two activities going on; there's the inbound from CMCs, if you like fresh claims coming in, and there's some remediation work that we're paying for and doing.

You saw us take a charge in the second half, for remediation provisions. So the blended rate that you're seeing, that £250 million, is a combination of both. It's quite hard for you to unpick that and I know that's the point of your question, and we haven't called that out. Suffice to say that based on flow projections that actually for the first time ever since I've been in the PPI game, we're seeing claims coming inside our own projections. I don't know if that will continue, but at the moment it does feel quite conservative. It remains to be seen though.

Chintan Joshi
Thank you, and then one follow up on the Non-Core; £23 billion RWA rump at the end of 2017, a lot of that is Op risk and derivatives. 2018, 2019 are now getting within the investment horizons for most people; should we expect a meaningful drop down?

Tushar Morzaria
It continues to flow down. You probably won't be able to see it as clearly because obviously it's going to be back into the Core, but absolutely, it's not a fixed rump. The Op risk will be pretty sticky; I don't think that's going down any time soon, but the derivatives component will. The Op risk is the one thing I think when I look back, I expected that if we shrunk so much we would get some Op risk benefit; but I just don't think that will be coming.

Chintan Joshi
And finally, on UK cards, you mentioned your conservative assumptions into next year. If we do get consensus GDP of 0.7% next year, what's the sensitivity to credit losses there?

Tushar Morzaria
It's more unemployment than GDP, so the rate of change of unemployment is probably the single largest factor. If you think, soon after the Brexit vote, we were at unemployment of about 4.9% in the summer. We are still at 4.9%, and I think consensus Bloomberg economists’ compiled consensus was 5.3% for year-end. That's a massive increase in unemployment in a relatively short space of time and if you didn’t see delinquencies [increase] in UK card then that would really be something. And it's usually the rate of change, not so much the absolute level of employment; of course that does matter, but it's the speed at which you move through the increase in employment. So if it's a rapid hike up to 5.5%, let's say the first quarter of 2017 is a disaster and job losses everywhere, that's going to be quite expensive I think. If it's more, if you like, of an orderly progression, it will be a more muted effect; that’s where the collections process and forbearance and things like that can kick in and manage the credit risk. But if it's a sharp spike it's quite difficult for us to manage.

Chris Cant, Autonomous

I just had one very quick one on your structural hedge, the £1.4 billion [of annual income]. I was wondering if you could give us a sense of how that splits across Barclays UK and BCI? I imagine it's mostly in Barclays UK?

Tushar Morzaria

Again not something we've called out. It is mostly Barclays UK but I'm not sure I'm going to help you in terms of giving a proportion of that. Regarding your assumptions that it's mostly UK, yes; the equity structural hedge of course is proportionate to the Group, but the product hedge isn't.

Hopefully that’s been helpful, and again please feel free to give us your feedback.

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