Barclays PLC Q1 2017 Results

Sell-side analyst breakfast transcript (amended in places to improve readability only)

03 May 2017

Tushar Morzaria, Group Finance Director

So, this may be the last time I go through my five or so objectives that we have had for ourselves for some time. We're hoping at the half year to pivot away from a Core and Non-Core split but maybe for old time's sake we will run through the usual five priorities.

So, Core returns – we wanted to keep that in double digits. We posted an 11% return on an increased equity base from this time last year. There were some one-time items in there that we called out on the revenue side. There are also items in there on the cost side which we haven't chosen to call out. So that's why when I look at the results those are offsetting amounts and I think of it as a genuine double digit return on a higher equity base, but obviously you will have your own views on that.

Non-Core closure is on track, and we are still aiming to fold Non-Core back into the rest of the bank at the half year. We are still targeting around £25bn of risk weighted assets, and we will talk more about where those individual assets will end up going; obviously it will be a dilution effect into the two main divisions of the company as a consequence of that and we will help you understand what dilution to expect.

With regards to capital, we continue to have a steady march up towards our end-state capital level. In some of your research notes a few of you were probably looking a bit more closely than I expected at some of the words that I was using during the results call, regarding whether I was changing capital guidance. I wasn’t really. I've always maintained that it would probably be the upper end of the range of capital that I think would work for Barclays and the reason to be at the upper end is just that there are a few things that still need to go through the system: for example, IFRS 9, whether Basel 4 actually happens or gets pushed out beyond any meaningful time horizon, some conduct and litigation as well. So I think when all is said and done, you would expect us to operate at somewhere around 13% and whether that's 12.9%, 12.8% I'm not really trying to fine-tune it within 10bps, so it's really more of an approximate 13% is what I meant to say.

On costs we continue to try and improve our efficiency metrics - we're at an interesting juncture in the company where we're getting pretty close to this 60% efficiency ratio but we're not there yet so I still think we have got a bit of work to do into this year and next year to make sure we have got a good flight path to get there. We're moving away from absolute cost levels and will manage the company on an efficiency basis, so therefore if income is lower we will continue to manage to that 60% cost: income ratio and do what we can to deliver that.

If income does go on the up side, and that's not a forecast, I don't think you will see us drive the efficiency metrics of the company down further. If it's sustainable income increases, I think you will see us take some of those efficiency gains and reinvest back into the company, but still trying to run the company at least at a 60% efficiency ratio. I hope that gives you a sense of how we're thinking about it.
And then finally, legacy items, putting the past behind us; there are two that we called out in our results announcement. PPI, there’s some good news and bad news there. The good news, is I think we have more certainty and clarity as to the end date and the final claims period for PPI, but we did see a spike in our claims in March due to the FCA’s own consultation which finished on the 2nd March. It remains to be seen whether that’s a blip or whether that will continue, but it's just something that we will monitor. I think most banks have used historical claims and extrapolated forward in terms of estimating PPI provisions. As you get closer to an end date I think most banks are probably re-looking at what's the appropriate way to try and forecast claims with that in mind.

The other litigation item we highlighted was the Serious Fraud Office (SFO) investigation into the Qatari fundraising of 2008 and we just pointed out that, by their own reports, they are close to making a decision on the outcome of that case. So we will be monitoring that as well.

**Joe Dickerson, Jefferies**

Since you have stated that you want to run at the higher end of your end-point capital range, you really need the c.75 bps from the Africa disposal to get there. And one of the trigger points for realising that capital gain is government approval. What if we're sitting here next year and that hasn't happened? What are the options that are available to you to get to the higher end of that capital range?

**Tushar Morzaria**

As you have seen for the last three years or so, we have generated a net 100bps of CET1 ratio progression every year and that's after headwinds such as FX fines or PPI charges. I do think we're a very capital generative company, even in this quarter alone we have generated over 30bps of CET1 ratio driven by profitability.

Along the way we have been using capital for discretionary purposes, things that we didn't have to do: for example, we unwound deferred compensation, we didn't have to do that. We bought back some expensive liabilities, we didn't have to do that. If you go back for the last six months, we spent about 50-60 basis points of discretionary distribution for capital. So we have the ability, even after all of those discretionary actions, of generating about 100bps of CET1. We're reasonably confident that we will get to about 13%. If you're generating the kind of profitability that we are, and we can retain that, then we have plenty of time to get there.

I don't think the selldown of Africa is a necessity for us to get our end-state capital target, but obviously it's a very significant turbo boost for us. It's more the simplification of the company than a requirement for capital that drove that decision and we have talked about that on earlier calls. The risk/reward equation for Barclays didn't warrant continuing to be an owner of Africa.

The feedback that we're having from the Central Bank and the Treasury is positive. The minister's only been in his seat under a month, but we are still optimistic that it will come in due course. There's nothing that we're seeing suggesting that there's any change in stance that we're expecting. So hopefully we will get approval in due course and consummate the selldown in whatever way we want to do.

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

First just on the US rates trading mishap, can you just talk us a little bit more through that because clearly you have set out your stall as a bank of generating revenue in a much more stable way? Now, I appreciate that fixed income doesn't really work like that but nevertheless you have set that position out very strongly. The size of a miss in Q1 relative to peers does feel like there was an outside directional trading bet. It feels like it's been decided at the top level that we just need to start taking more risk.

The second question is on the US cards business, particularly around the US $1.6bn subprime card book, so there's a few sub-segments to this but firstly when did you actually get that book because the first time we knew that you had a subprime credit card book was when you'd sold it, so was that
something that you had originated yourself or is that something that you bought along the way? Second, what was the impact on the delinquencies at the end of the quarter, i.e. the benefit that you got from delinquencies dropping out from that disappearing? And also if you can just give us an idea about the revenue that will disappear because presumably it’s a very, very high yielding book. So, to summarise, could you give us an idea of the revenue and the bad debt that disappears in Q2 due to the sale of subprime card book?

Tushar Morzaria

So, with regards to the US dollar rates, yes, we were disappointed in our macro trading performance. However, we were pleased with our volumes that held up in terms of clients transacting with us. In our mind, any reduction in volumes is a much more worrying situation - if you go back to the dark pool incident in 2014 when clients actually withdraw business - it’s a much harder thing to get back. In this case it was trading rather than client flows.

It wasn’t an outsized position. It’s one of those things where we won't always get things right and our inventory was relatively small, you can see that in our risk weighted assets, probably one of the smallest risk inventory that we carry relative to our peers.

We were biased to the ‘Trump’ trade and ran a bit too much long volatility too far into the first quarter. When you're running a long volatility position, it will decay over time so you're paying for that through the carry in the book. You only need to have £2-3m of carry for the best part of a quarter and all of a sudden you can be £100-150m adverse. So it's not a trading loss, it's just the decay effect.

With someone like Tim Throsby coming on board, who is the first senior markets leader that we have had into the Investment Bank since the Bob Diamond era, we will continue to restock our trading talent and he will be a catalyst for that. If you look at credit trading, it performed pretty well, so with the US dollar rates trading we weren't capturing as much bid-offer as we should have done rather than running a skewed inventory position that we lost money on.

That's the negatives. We got it wrong and we should have done a better job. On the positives, it's very idiosyncratic and very easy to fix. Client flows are probably the one thing that we would be much more concerned about were that to be the case.

Michael Helsby

So you’re saying that that’s just normal course of business, that we should expect you to be doing better in Q2?

Tushar Morzaria

I think there are a few other data points. We had a pretty good first quarter this time last year, so compared to some others we probably had a slightly higher bar to get through. But nonetheless we were disappointed. We were lower than we would have liked to have been, and that was the main driver of it. We were better in currencies, I know a few banks called out the weaker currency quarter. We were better in financing.

In my scripted comments I did talk about the exit of some commodities related activity towards the latter part of 2016. That had a modest effect as well. We worry most about our clients not trading with us. If you don't have client flow then it's a much more difficult thing to deal with. But that wasn't the case for us. We can and should be able to fix this issue, but none of us are perfect and we won't get it right every time.

With regards to your question on when we acquired the US cards book, it's mainly our branded book so we are mostly a partnership business in the US, but we do have a percentage of our cards that are ‘Barclays’. That's a relatively small product being under two or three product codes, with the biggest one being the Arrivals product, and that has picked up some lower quality FICO characteristics. It's an
okay book, but I think we have always been a little bit cautious. The card market in the US is pretty hot at the moment; it's quite hard to find assets that you can price attractively. Probably since the Jet Airways transaction we have found it difficult to find assets that we like.

This was a slightly larger sale, hence we called it out, but it's not the first time we have done something like this and it's just good risk management for us. If we saw another opportunity to do something similar then we may take advantage of that depending on the returns that we get.

In terms of when the deal was done, it was done right towards the back end of Q1, so it really wouldn't have had an effect on Q1 delinquencies or Q1 impairment charges. In fact, the accounting doesn't reverse against impairment. Again, Investor Relations can take you through sale accounting for delinquent card portfolios, but it won't have affected the impairment line. It will affect the receivables line on the balance sheet. The net effect of impairment and the value we get for the portfolio goes to the income line.

**Michael Helsby**

So would there have been delinquencies in the portfolio in Q4?

**Tushar Morzaria**

Yes.

**Michael Helsby**

And why wouldn't there have been delinquencies in the portfolio at Q1?

**Tushar Morzaria**

Because we sold the portfolio at the back end of Q1. Any further delinquency we experience prior to the sale will be in our impairments line. At the point of sale, the stock of impairments that you have on the balance sheet doesn't get reversed back into your impairments line. It gets netted out in the income line.

**Michael Helsby**

Thank you. Clearly people are quite focused on the delinquency moves in the US, and it went up a bit and it went up a bit after this came out. So I'm just trying to get the scale of the delinquencies for subprime, presumably delinquencies were quite big?

**Tushar Morzaria**

Yes. They would have been in the delinquency stats rather than the impairment charge, it would have been in the arrears numbers that you would have seen in the first quarter. And you will see that normalise back over time as you go into Q2, Q3 and Q4. There are two effects that you will see: one effect being the bad books not being in there and the second effect is the American portfolio and of course Jet now starts becoming much more prominent in our books, so both of them will have a helpful effect on delinquency stats.

**Michael Helsby**

I'm sorry if I'm labouring on this but if you'd sold it before the quarter end, presumably it's not in that 2.3% number quoted in your results documents. So if it had of been there at quarter-end, it would have been in the 2.3% number and the delinquencies would have been higher. So I'm just trying to get the scale of what the benefit of selling the portfolio was in the arrears rates.

**Tushar Morzaria**

Investor Relations will dig it out for you, but in terms of trying to help you think about how to model this, at least on the impairment charge line, you saw that come down Q1 versus Q4 and I think you will
continue to see a normalisation effect as the risk mix of the book changes, and that will be accompanied by the arrears rates showing through. But we will get confirmation as to exactly what was included in the Q1 published arrears rate to aid your modelling.

With regards to the revenue impact, ultimately when you sell a book at a profit you are pulling forward income you would have otherwise earned, assuming you got the risk call right. In our view it was a very attractively priced transaction.

It's not significant in any one particular year and I don't think we will be calling out the revenue effect in comparable quarters from this book being sold. I don't think it will be that noticeable. So you're right, there is a pull forward of income but I don't think it's significant.

**Raul Sinha, JP Morgan**

Is it a higher yielding book than the rest of the book?

**Tushar Morzaria**

Yes, by definition it would be, but it's yielding if you have got the risk management of it right.

**Michael Helsby**

Just finally to wrap up on this, so as I said we didn't really know that you were originating your own subprime cards in the US. You've always put a stall on the fact that it's a prime book etc., so when we think about the UK and risk appetite, I appreciate you got your Access card, how much of the UK book would be classed, if you measured it in a comparable way, as subprime?

**Tushar Morzaria**

Just to talk about the US and then I'll come back to the UK, it's not subprime in the traditional sense, i.e. everything lower than a Fed and FICO score. It is lower quality, not all subprime, and most of it was our branded portfolio. If you want to sell any of your partnerships you also need the agreement of the partner brand as well, so that's why it's easier to sell your own book than it is partner brands.

Generally speaking, you will have a spectrum of credit in the US. We're very good but if you look on a pure FICO score, there will be a spectrum. A good example at the top end is American Airlines being the most prime type of customer profile, whereas Apple is a much younger, up and coming, affluent type which will have lower FICO scores, but has really good returns and we like that business a lot. Then you have a spectrum of all the stuff in the middle. We wouldn't be keen, for example, on selling the Apple book even though it may look lower quality. It's a very fine performing book and we like it a lot. It's probably just our branded book that we would offload from time to time, just to manage the risk mix.

We are a large participant in the UK, so you'd expect us to partly be representative of the market. You'd expect that, given the market share that we have, but probably skewed a bit more towards the prime book, if you look at just a market average. We haven't given out any stats on that, so I won't share that with you on this call.

**Edward Firth, KBW**

Could I just come back to the US cards business, if you look at the provisions number it was actually a little bit better than I was expecting, so what's your appetite like there because it has been growing at a pretty healthy rate over the last few years? Do you still have that sort of appetite or should we expect to see volume growth there? If you strip out the disposals etc, this underlying appetite; should we expect volumes to continue there or are you actually going to be slowing that down and we should expect a much more measured low single digit outlook?

**Tushar Morzaria**
We do like the business a lot. This isn't a call on the cycle, we're nowhere near smart enough to try and get those things perfectly timed. But we like the business a lot and we would love to grow it. We have grown it a lot, but it's just that we have found pricing very hard, particularly in partnerships which is really our staple product. So where we see opportunities that make sense for us, absolutely, but we will try and keep our pricing discipline.

These are very long-term contracts, with some going out more than a decade, so if you do price them incorrectly it's very hard to reverse your way out of it. Pricing discipline is very important and that's one thing we learnt from the last cycle. One of the reasons why the US cards business is performing so well is that we priced very well coming out of the last cycle and didn't pick up stuff going into the cycle at elevated pricing that we would have still been stuck with. So pricing discipline is important.

We'd love to grow the book. We like it a lot, but pricing discipline is trumping our ability to grow as quickly as we would like. Having said that, we have grown it an awful lot and receivables are up 40-50% I think almost the last few quarters. I think there will be a period of digestion that we will go through as well. In some ways the American portfolio coming online, which is the biggest part of our partnership book, is in and of itself going to grow the book again. So we don't feel underweight in terms of the likelihood of that book growing but pricing pressures are pretty keen still.

Raul Sinha

I have two questions. The first one, going back to your opening comment, you do consider this RoTE that you stated for the Core business to be reflective RoTE and implying that there were obviously some cost one-offs to offset the revenue one-offs. Could you touch upon maybe the areas in which we might be missing because you were very helpful in giving us the revenue one-offs but you haven't given us the cost one-offs? So obviously on the ring-fencing costs, on the call you mentioned that you were going through the belly of the curve. Is that £100m quoted the right way of thinking about that and is there anything else apart from that in the Core business?

Tushar Morzaria

We deliberately didn't call out a number. It's one of the things that we have tried to avoid doing since Jes came in, so we don't call out CTA charges and structural reform costs. Costs that were going through there this quarter, were the continuing unwind of the deferred compensation and that's between £200-250m for the year. It's a bit front-loaded because of the shape of the compensation accrual. So that will disappear next year.

We obviously now have real ability to change our bonus accrual in the way the American houses can do, so again you'd expect that to track revenues much more than it used to when it was really just old stuff rolling in with no real revenue shape attached to it. Most of the Americans have more comp in the beginning of the year than at the back, so we will look a little bit more like that.

Structural reform costs are definitely going through and we're probably in peak year. We have just received our banking licence for the UK bank. It will be the largest UK de novo bank ever created. It's going to be millions of sort code moves and account changes. There is enormous operational work going on behind the scenes and we're in the peak part of that. That will subside as we get into next year and beyond and the bank will be up and running this time next year.

So without calling out individual numbers, there are costs going through there now. One of the reasons we haven't called it out is that we don't want to get too much into managing to hard cost targets. We're really focused on efficiency measures and we look at these things in the aggregate and we will continue to drive that towards 60%. If income declines, we will manage the cost line accordingly and if income was to grow, again we will still target at least a 60% cost efficiency ratio, but that will give us more capacity to reinvest back into the Group.
Raul Sinha

Just on UK cards, there's obviously a lot of concern about the 0% balance transfer book. I think if we look at the best buy tables now, you're no longer at the top. Previously you said that being at the top of the table gives you access to the best quality credit, meaning that you can pick and choose. So does that mean that you're now actually stepping back from that market?

And then secondly, the concern is that because the lengthening duration of the 0% balance transfer deals, there is a lot of unpaid balances now on this particular product that might more reflect the quality accurately, so what might be the risk for you from here if there was some action taken by the regulator?

Tushar Morzaria

Yes, no change from what I've said probably previously which is that we like the product, but we are finding it difficult to make the numbers work with such super-long dated balances. There is a risk management advantage to being at the top of the table. You get to see everybody's applications and therefore your underwriting should be of higher quality. But of course if you can't make the numbers work, then it's a false opportunity. We're a bit below the top of the table. Some other banks operate on multiple brands so you can see one or two banks that are really interested in this area and they are top of the table, but that's through multiple brands.

You will see us pulse in and out occasionally. We were top of the table earlier in the quarter around February, and in some ways it gives you the opportunity to get to see all the applications again and just reaffirm the risk management perspective that by not being top of the table, you're not getting a weaker underwriting. Previously we would have been top of the table with a product we liked a lot, but I don't think you will see us do that again.

In terms of the 0% balance transfers, I'll throw out a couple of stats. I know there's been a lot of interest in the accounting, so we're less than 5% effective interest rate (EIR). You can compare that to peers if it's helpful. In terms of the amount on our balance sheet, I didn't call out that number but it's incredibly small, less than £40m from that particular product, so it's not something that concerns us as an accounting matter.

If the FCA was to change the regulation, we will just take that into the round. I don't think there's anything as yet that we're seeing that gives us that much concern. But let them do their work, let them do their review and let's see what comes back, but there's nothing I can see at the moment that feels particularly concerning. So we will wait and see, rather than commenting while the review is ongoing.

Ian Gordon, Investec

Can I just have a quick follow up on that last question? The less than 5% EIR doesn't mean very much to me unless I've got some idea of what the duration is, i.e. how much of the reversionary rates go into that, otherwise I'm not comparing eggs with eggs. So can you help me on that?

Tushar Morzaria

Yes, that's why I threw out that other statistic. If you think about what's on the balance sheet in terms of income that's accrued on the balance sheet, it is less than £40m. So if we were doing any effective interest rate type accounting at all, we would write back a debit of £40m back into our P&L.

Michael Helsby

I'll keep it on the same theme of the 0% balance transfers. Just to clarify the less than 30% that you quoted, is that just balance transfers or is that 0% balance transfers, because at the last breakfast you said you're more into the combo product.
Tushar Morzaria

Yes, that's 0% balance transfers, less than 30%, of which the majority of that book is less than two years as well. So the majority of that book is our own customers and they tend to have even shorter balances. A lot of people thought it was some sort of huge book with 30, 40-month 0% balance transfer dominating it, but it's not that significant at all.

Michael Helsby

Just taking a step back and thinking more holistically about the retail franchise, it's getting really frothy out there in terms of pricing.

Tushar Morzaria

In terms of buy-to-let?

Michael Helsby

Yes. It’s crazy. Banks are selling buy-to-let loans for cheaper than the two year fixes, or five year fixes. It’s getting crazy again. You have always talked about discipline, and I respect that you really believe that. So, as it gets worse should we expect you to just step back like you did in Q1 and for the loans to just shrink from here? I know you said actually you’re more stable, but if we just think ahead about the behaviours of other banks, surely you think you should just step back and just be ready for it when it all starts to go wrong.

Tushar Morzaria

Yes. We’re not trying to call the cycle again, to be clear on that. We’re not going to decide one day that we think the cycle is turning. That’s not at all how we will operate.

We are cautious on the UK outlook. Definitely cautious, and have been for some time. I think the economy surprised, probably on the upside, which is nice. But we have been cautious.

We have seen other banks grow their books way quicker than we would be comfortable doing in buy-to-let and other types of mortgage product, or indeed unsecured credit. Time will tell whose stance is the most appropriate.

We will continue to be active in the parts of the credit spectrum that we know and like. Traditionally for us we have been in the re-mortgage space. Traditionally in the c.80% loan-to-value, an area we have done for decades and decades very well. If you look at our average market share of UK mortgages, we’d be substantially higher than that in the re-mortgage space at those LTVs. We like that product a lot and you will continue to see us active in those parts of the credit spectrum, and the same for some forms of unsecured credit as well.

But what I don’t think you will see us doing, and we haven’t done since the last crisis, is move meaningfully into parts of the credit spectrum that we haven’t traditionally operated in.

So, I know your note was focused on buy-to-let. That’s just not an area that we have emphasised in terms of growing or getting into. We will continue to operate in that space, and you won’t see us disappear completely, but you won’t see us do anything more than we’re currently doing with our underwriting standards that we currently have and it’s a relatively small market share that we have in that.

We are cautious, but definitely open for business, and particularly open for business in the parts of the credit spectrum that we have always been very active in. We would like to grow our balance sheet in those parts of the books, and that will be an objective for us.
Chris Manners, Morgan Stanley

I have a couple of questions, still sticking on the UK. You say you’re concerned about what’s happening in UK macro. Do you actually expect a big deterioration in consumer lending asset quality? Do you actually expect the impairment charge to go up meaningfully from where we are over the last few years? It’s actually been relatively benign when I look at your delinquency stats in Barclays Consumer UK, you point out they’re still improving. So, where do you think the impairment charge could go?

My second question is: if you are more cautious and you’re growing more slowly in the market, does that mean we could actually see your net interest margin (NIM) continue to beat expectations? You can focus on at least your best revenue generating customers.

Tushar Morzaria

Yes. In terms of where the impairment charges go, there’s nothing that we can see in our books that would suggest there’s a problem in the near term, and of course you can’t see that far ahead, so this isn’t reacting to very obvious signs of credit stress going on in our book. We have just been cautious for some time and I think the risk-rewards are balanced, so it’s probably not the right time to be putting your foot down. At least that’s our judgement.

Arrears rates are benign, and we’re not seeing anything that suggests any likelihood of them picking up in the near term, but we can’t see that far out.

We have a lot of data in a bank like this and we can monitor derivatives of consumer behaviour through other banking channels and see what customers are doing that may forewarn what may happen in terms of arrears rates. So, it’s something we’re extremely vigilant on monitoring closely, but I would stress that, nothing that we’re seeing tells you that we’re walking into a new consumer credit cycle. We are cautious and maybe that’s the right stance, only time will tell.

In terms of net interest margin, what you saw in Q1 was the repricing of the deposits flowing through after rates were cut in summer last year, around the time of the Brexit vote. The actual process of transmitting rate cuts to deposit holders in the UK is quite long and drawn out. You have to physically write twice to the customer to notify them it’s going to happen. It takes about three months to do, hence it really took effect in December.

You have just seen the full quarter effect of that, and pricing on the asset side has been okay in Q1, but it is has a lot of active elements, so I do expect pressure on that, hence why we do not guide to above the upper end of the range we quoted at full year. I think we will be at the upper end, but it’s too early to guide more than that, simply because I think asset margin pressure will continue to be there in abundance and we will see how we navigate through that.

We’re not shrinking our balance sheet and we’re not trying to keep it flat. We do want to grow our balance sheet, but only in parts of the book that we like.

Joe Dickerson

You mentioned the FCA looking into this cards issue. What power do they have? This is an international accounting standard. Are we supposed to change the whole international accounting standards because Lionel Barber from the FT is concerned about this?

Tushar Morzaria

That wasn’t a comment so much on the accounting standard. You’re right, there’s been an international accounting standard – presumably they will govern that. I was referring more to whether they want to regulate the product. I have no expectation that they will, but let’s see what their review concludes.

Chris Cant, Autonomous
I just wanted to follow up on your comments about creating the ring-fenced entity as a new bank. And following on from the question I asked you on the results call around the allocation of Pillar 2 capital. If you’re creating a new entity, how do you practically deal with the pensions for the employees who are going into that entity? I’m guessing that actually, if that’s the way you’re doing things, a large portion of the UK ring-fence will remain outside in relation to historical employees.

**Tushar Morzaria**

It’s a very good question, but unfortunately I am not going to be able to answer it on this call. There will be a time, hopefully, in the next few months that I will be able to answer it very directly. The reason I can’t is simply because those are discussions that are ongoing with the trustees themselves.

It is really tied up as part of our tri-annual negotiations. They are progressing very constructively, but they will conclude in the next few months. Clearly the pensions regulator is part of those discussions as well, so it would just be unfair for me to give a live commentary prior to those agreements being finalised.

I would say that we will get to a very good place, and it will be good for the employees, the eventual set-up of the bank and the regulators as well. But it’s something I’m actually not that concerned about.

**Chris Cant**

On the UK entity, you talk about 60% cost: income ratio for the Group being your longer term target. In the past you have talked about wanting to get the Barclays UK business down to sub 50%. I just wondered if you could speak to that, is that still the intention?

Within the UK entity specifically in terms of the ring-fencing costs going through this year, in the past you have talked about £500m spent across 2017 and 2018 combined and frontloaded to 2017. Is that still the case?

**Tushar Morzaria**

We did have that £1bn budget and that’s about right, yes. This is the peak year there’ll be a tail of it that goes into 2018, and obviously we spent some in 2016.

The cost efficiency objective for the UK bank will be to get to a 50% cost: income ratio or below. We’re getting closer to there, but not there yet.

**Andrew Coombs, Citi**

I have two questions, with the first on net interest income. More specifically, you talked about the UK and its product repricing, you used quite a bit of colour on the move in the international margins. It’s a bit tricky for us to follow this, because if you don’t disaggregate it between the investment bank and US cards. So could you give a little bit more detail there on the move up?

For my second question, could you provide a bit more colour on the US equity derivative performance? Also more broadly, you made a lot of Emerging Markets (EM) and Asia-Pacific (APAC) exits around about this time last year. So, I am trying to get a feel if that’s already dropped out in the year on year comparisons, or whether there’s more of that to come in Q2.

**Tushar Morzaria**

I’ll answer those in reverse order, there is a bit more to come in Q2. We made these changes, as you rightly pointed out, and announced them in March last year. It doesn’t drop out instantaneously, so there might be some to drop out in Q2 and beyond. These weren’t huge parts of our offering anyway, so I don’t want to overplay its significance.
On US dollar equity derivatives, again, we had decent flows although we didn’t capture as much of the bid-offer as we’d like. A similar situation to US dollar rates, we didn’t quite get our skew of inventory right, and we held on a little bit longer than we should have done. With Tim Throsby being of equities pedigree he got on top of that pretty fast. So I do not have much more to add, apart from volumes actually held up pretty well. Actually cash equities were better year on year and financing did better year on year. Our prime balances went up to quite a decent amount, so we felt pretty good in the round.

International net interest income, or net interest margin, we haven’t broken that out. It is dominated by the US card business, but we do also have the German card business and a joint venture in the Nordics in there as well. It’s healthy margins as you point out. Over time, as we get towards the completion of ring-fencing, one of the things you will probably look forward to receiving is the statutory accounts for both the International and the UK bank. Given that there would be statutory entity, we will probably end up having to disclose more inside those statutory entities than we do at the Group accounts today.

Fiona Swaffield, RBC

Just coming back to capital, obviously one of the options you have talked about potentially is redeeming the remaining expensive preference shares. In terms of timing, do you think that’s contingent on being well above a 13% CET1 ratio, or do you feel you have to have completed the selldown of Africa before that could happen?

Tushar Morzaria

I cannot comment on that. We have been cleaning up our liabilities as we go along. We haven’t given ourselves trigger points to allow us to do that. If we feel we can absorb it within our capital glide path, we will do that and we will be opportunistic about it.

It’s unfortunately a lot more expensive that it could have been, had we been able to do it earlier in my tenure here. It’s not the only interesting thing on the liability side of our balance sheet that we could do things with. I probably shouldn’t say more than that, but it’s just one of a number of options that we have available.

Martin Leitgeb, Goldman Sachs

Two questions from my side, please. The first one is on capital distribution within the Group, and your disclosure on the UK ring-fence is very helpful. I was just wondering if you could share your thoughts on potential size of some other bits within the structure. In particular, the operating subsidiary and potentially what is outside of the UK, of the remainder.

And the second question. I think you commented earlier on how big your European business and non-UK European business is outside of that ring-fence. Could you give us a bit more colour on how big that entity could be going forward? Just on the assumption passporting would no long work and that you would need to set up a separate legal entity for that.

Another question is to build on the other question earlier on what would happen if Africa doesn’t materialise. Do you need approval to selldown once, or does every step require approval from the authorities? Secondly, if I go back to your earlier answer where you said that if the selldown of Barclays Africa doesn’t materialise then you still generate 100bps of capital. Are you implying you would keep the dividend for a bit longer? Or are there other alternatives within that optionality within the structure that you could do?

Tushar Morzaria

The service company does exist as the legal vehicle, it’s not populated out. We expect to be standing up the service company for real, rather than just as a legal entity matter and operationalising it in September. It’s not going to be a regulated entity, therefore it doesn’t need to hold capital as a bank recovery resolution matter, or a prudential matter, but more as a regular corporation - what’s going to
be called as an appointed representative. It’s actually quite capital efficient, so it only needs a very small amount of capital for our services to continue in the event of a bankruptcy. Its capital requirements are relatively modest in the scheme of the Group.

For the European bank, as you know we have got an Irish bank that’s already up and running and licenced. It’s very, very small at the moment, but that will likely have a meaningful position in European operations, and we will build that out, unless something different happens on passporting.

It’s too early to give out too many numbers on how big it could be. When I look at all of the things we have had to do to re-organise the Group, whether it’s setting up the IHC in the United States, CCAR etc., this doesn’t feel anywhere near as big as that. It is not as big in terms of the operational disruption, or in terms of the amount of the financial assets and passing things up. I won’t give you specific numbers, but it is a much lower list than what we have had to do in the past.

With regards to Africa, we need government approval to sell down below a controlling stake, and that’s it. Whether we choose to own 49.9%, or 0%, we will need just one approval, and it’s the same approval. So it’s only one more approval to go and then we have freedom to divest accordingly.

We are confident that the selldown of Africa will happen, that’s our base case. I cannot address what would happen to the dividend if the selldown of Africa didn’t happen on a call like this. It’s a matter for the Board who would decide future dividend intentions.

**Namita Samtani, Macquarie**

I have a question on your cost: income ratio target of 60% for the Group. If I look at some of your Nordic peers, they’re around 45%. So, what’s stopping you from saying that today Barclays can be a 50% cost: income ratio type of bank?

**Tushar Morzaria**

I think a better comparison to the Nordics is probably our UK bank, because the Barclays Group has much more of an international footprint than the Nordics do, but the UK bank looks and feels more like some or one of our Nordic peers.

In the UK bank we are targeting a sub-50% cost: income ratio. We’re in the low 50s at the moment. We’re going to try and get that to below 50% and keep going.

Compared to the Nordics, we have a much larger branch footprint, which doesn’t help of course. Swedbank has far fewer branches. Nordics also have to handle substantially lower amounts of cash than in the UK, there’s only a handful of branches that actually can handle cash. It’s a different model there, but definitely something we’d aspire to get after at some point.

Since I’ve been here we have probably closed around 300 branches and we will be a reflection of how our customers want to bank. With fewer people going to branches, there is less need to have them.

**Claire Kane, Credit Suisse**

I have a quick question on pensions. Could you give us an indication of when we might hear the conclusion of your latest discussions? Also, should we expect that the 2017 agreed contribution could change materially, at least for the second half of the year once that’s concluded?

**Tushar Morzaria**

I can’t give you a date, but if you go back to the last tri-annual review the discussions started around September 2013 and took the best part of a year, finally concluding in September 2014. We started in September 2016, so maybe we will have the conclusion during Q2, or Q3.
What that will do, assuming there’s going to be a change in the prospective contribution schedule, it will take effect from the point at which the discussions are concluded. So, potentially yes, but it depends on the date on which the discussions conclude.

David Lock, Deutsche Bank

With regards to costs for the UK, could you please talk about how the integration of Barclaycard and Barclays UK is progressing? I think it’s been about a year since they’ve been together, and as far as I’m aware they still use different contact centres, different account numbers etc. What is the potential synergy opportunity there longer term and how long we might expect that to kind of come through?

Tushar Morzaria

It’s something that we’re actually pretty excited about. These divisions have been operated separately for a long time. They have different features, like branding, so there is an opportunity to bring this together.

There are operational synergies, such as single contact centres, single account opening procedures and single fraud detection algorithms. There are also synergies on the revenue line, we’re already a large participant in UK unsecured credit, but we could probably penetrate our own customer base with Barclaycard more than we have done. That’s a very obvious opportunity for us.

We did an okay job when they were running as sister divisions. But when it’s a single division, obviously the intensity of doing that is even more significant. I think over time you will see a lot of the benefits coming through.

The service company is also a huge enabler on this, which is something that we have been very deliberate about. If you house all your operations under a single umbrella structure, the ability to share and do things once is so much greater than if we were housing everything in the respective banks. For example, collections and fraud in the UK for cards and retail run together, so there’s no reason why fraud detection in the US and in the UK can’t be similar. A service company can make sure we get the best of both worlds there as well.

David Lock

In terms of how long this will take, clearly the focus is very much on setting up the ring-fence entity and moving all the account numbers across. But, is this a five year project, or nearer term?

Tushar Morzaria

It’s much nearer term than that. There’s only so many days in the year and ring-fencing is trumping everything else this year and we have to get that done, but at the same time as we set up the service company. We call these transaction cycles and Paul Compton is going to be speaking at your conference in May in the US where he might touch on this a bit more.

There are various transaction cycles and the fact that they are housed in a single service company allows us to realise those synergies from today onwards, but only once ring-fencing is complete and in a shorter time frame than five years.

Jonathan Pierce, Exane BNP Paribas

My first question relates to your earlier comment that you’re going to be targeting about a 13% CET1 ratio, almost regardless of what the outcome of IFRS 9 is. It sounded like even Basel RWA inflation would be taken account of in that as well. Is that right?

Tushar Morzaria
Unfortunately there is not a magic number. The regulator doesn’t specify what every bank needs to hold, so you have to triangulate it.

I triangulate it in two ways. The first is to have an appropriate buffer above any MDA level, which is a judgement call in my mind, from around 150-200bps, that feels appropriate. This may change over time, which gets you to a CET1 ratio of between 12.3% and 12.8%. The second thing we look through is whether we have a sufficient drawdown capacity for any Bank of England stress tests, or any other form of stress test. We drew down a little over 400bps last time, so we are making sure that the bank is above its systemic reference point.

When I triangulate that, it feels like at the upper end of that range feels appropriate and I just round that to 13%, I’m not trying to be too cute in terms of targeting a precise capital level.

The other reason to be at the upper end of that range is that we do have some unknowns to work through, like IFRS 9 that you mentioned. We need to understand what impact any potential transitional rules have and how the market takes them on board, amongst other things. We called out a couple of legacy items that still need to be worked through the system, like Basel IV. As a result, we should operate at the upper end of that range, nearer 13%. As the passage of time continues, and we clarify some of those uncertainties, we may choose to revise our capital requirements, either upwards or downwards.

There’s talk of a countercyclical buffer, so let’s see if that comes in, what the timeline is and where that sits along the path of other things that are uncertain.

Jonathan Pierce
On the call you mentioned operational risk again, which we haven’t heard about from you for a little while. It surprised me slightly because your op risk is quite high, relative to others. What’s your thinking there?

Tushar Morzaria
Nothing really, operational risk is just an example of, in a Basel IV world, one of the risk factors still out there. I’m not suggesting that something is going to happen on operational risk in the next week, or the week after, but it’s just one of those things where it would be nice to have the rule book stable.

Jonathan Pierce
Just to follow up on IFRS 9, it plays importantly into this because of the revolving retail exposures in particular. Can you just give us an update on how things are going with the auditors? I’m hearing from certain places that there is a bit of a dispute between the auditors and the banks on credit cards, as the banks want to use an expected life of around 2-2.5 years on stage two assets, but the auditors are pushing for more than that. In terms of stage two amounts, I am also hearing is that the auditors are guiding to 25-50% of the book being stage two and stage three as a combination.

If we go into an economic downturn, this could lead to some very big expected loss provisions on a lifetime basis. Can you talk about the expected life on stage two and the amount on stage two?

Tushar Morzaria
I can clarify that we are not having a fight with our auditors, we are very much in a constructive dialogue. I’m not sure what you’re hearing, but everybody is doing this for the first time, so it doesn’t surprise me there’s going to be a spectrum of outcomes. Reasonable people will get to reasonable outcomes, but they’re just different and those differences will need to be bridged.
We are reasonably far advanced on our modelling and we are in lockstep with our auditors. We have also had an auditor transition, but the transition team has been keeping very much abreast of what we’re doing, so we are in reasonable and good position.

You are right about pro-cyclicality, but I think it is too early for me to start talking about ranges and how much it’s going to be. At the right time, we will have to disclose those numbers, but I suspect it will be sometime in the second half.

I do share your concerns in terms of pro-cyclical accounting standard, and it is absolutely something that we as management and you as market participants will all need to recalibrate ourselves to.

Edward Firth

I don’t want to labour the point on capital, but you have potentially got a preference share purchase, a PPI liability, the US RMBS fine, IFRS 9 and pension costs coming through. These are all negative on your capital outlook, yet on the positive side we have got the selldown of Africa, which is the only one to offset that whole list. Is there something else that we should be thinking about, which is going to help offset some of the pretty sizeable capital headwinds that are still to come through?

Tushar Morzaria

Over the past 3 years there has always been a lot of headwinds, whether it’s RWA rule changes or conduct/litigation fines, there has been a depletion of capital levels in all UK banks, yet Barclays progressed forward in capital on a net basis every year.

Even in this quarter alone we accreted over 30bps just through organic earnings, with more accretion through the reduction of Non-Core RWAs. We then spent some of that capital on buying back preference shares and not issuing shares for employees. There are actions that we will continuously take to try and balance returns and capital accretion to plot that path as well as we can. I think we have done an okay job of that up until now.

To get another 50bps from where we are today doesn’t feel that difficult for us. We will zig-zag up there, just as we have been doing for a little while now. If the selldown of Africa happens, of course that’s a turbo boost, but Africa’s more about simplifying the Group structure. It does come with a capital benefit and the capital benefit will be whatever it will be, depending on the share price and market conditions. But that is not a forecast on what we may or may not achieve from that.

Edward Firth

In a context of a sector where a number of your peers are throwing off 200-250bps of capital, and that’s a theme that we would expect to continue over the next two or three years. You do seem to be sitting as something of an outlier. Is that a fair comment?

Tushar Morzaria

We have chosen our own way to get to our capital position. We didn’t have to do any of the discretionary actions that we have been doing, and would be well over 13% already - probably nearer 14%. We are trying to balance the objective of generating returns while growing our capital position, plotting that path as well as we can. We feel pretty good about our progress.

Chris Cant

You said you want to maintain 150-200bps above your MDA, and mentioned counter cyclical buffers but would the counter cyclical buffer not be part of your MDA?

Tushar Morzaria
Yes, that was one of the points I was making. Whether it comes or not, we will recalibrate accordingly. The 150-200bps guidance was deliberately a relatively wide range. Are you asking me whether it is immediately additive to that range, or would be absorbed into the buffer?

Chris Cant

Yes, I would guess you would absorb it. When you said specifically you want to maintain that level of buffer over MDA, is that a function of your expected volatility, or are you setting out that 150-200bps with the 1% through the cycle counter cyclical buffer that Bank of England’s guided to in mind?

Tushar Morzaria

I can’t give you a straight answer to that, only because I think you have got to look at these things with all the other things going on at the same time. If I knew the answer to IFRS 9 and if I knew whether there was any decision around conduct/litigation we would probably hold a much tighter buffer range above the MDA because the level of variability is much lower.

So, it’s not a direct answer to your question, but I would say that for now we are guiding to a CET1 ratio of around 13%. Taking all near term headwinds into account, targeting around 13% feels about right.
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