Barclays PLC H1 2017 Results

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

Lee Street, Citi

Hello and thank you very much for taking my questions. I have three questions for you, please. On slide number eight - I think you referenced it in your comments - the appropriate balance of tier two will be informed by the relative pricing of senior and tier two and investor appetite. I was just wondering if you could give us any indication of what you might see as the pricing differential where you'd look to do tier two over and above holdco senior.

Secondly, you mentioned the idea of permanent grandfathering of some of the older holding companies' senior issuances. What is the, what do you think the likelihood of getting that permanent grandfathering is and what might be the timing on that?

And finally in your report in the notes on litigation there's the comment about the potential for the SFO to bring a charge against Barclays Bank Plc. Obviously a hypothetical question but if that were to happen and Barclays Bank Plc to be found guilty, are you able to comment on what might be the potential ramifications given that that's obviously the regulated bank entity? They'd be my three questions. Thank you.

Tushar Morzaria, Group Finance Director

Thanks, Lee; Tushar here. Why don't I take the third one on litigation and Dan can cover on tier two and grandfathering. There's not much obviously we'll be able to comment given that's a live and fluid situation. Of course in terms of whether there's any impact to the bank were it to be found guilty - which is all very hypothetical, we haven't even been charged at the bank level yet - I think really what it boils down to is given the specifics of this particular case to do with a capital-raising that was at a point in time done some time ago rather than ongoing products or services or interaction with ongoing clients, I think regulators would probably take that into account when assessing whether there's any change to our licences or anything like that.

I probably really can't say much more than that given it's a live situation and just refer you to our disclosures. Dan, do you want to comment on the other two?

Dan Hodge, Group Treasurer

Yes, sure, thanks, Lee. In terms of the tier two and the relative issuance there of senior versus tier two, you can tell from our behaviour in the past, the rates at which we've been happy to issue tier two and senior. We're obviously happy where the spreads are today, they've come in quite a bit, even if they widened out and we expect this to continue to be a regular issue in both of those particular asset classes.

In terms of when we might expect to see some permanency of grandfathering, it obviously very much depends on when CRD5 and CRR2 themselves become finalised. We don't have the kind of inside knowledge on that one so it's not clear at this stage so in the meantime when we put terms in our instruments we very much reflect what the Bank of England require of us - but certainly the mood

music in Europe seems to be moving towards a permanent grandfathering as opposed to having some sort of sunset date and therefore I think that the probability of some of the existing securities, being offside on a retrospective basis is kind of fading.

Lee Street, Citi

Okay, that's very clear, thank you for your comments.

Greg Case, Morgan Stanley

Hi, guys, thanks for the call. I'll follow Lee as well with three questions if you don't mind. So firstly, last year you guys did a lot of liability management exercises. We haven't seen, I don't think, anything this year. Is it that spreads have gone up too far, are things just like tired out in terms of how many times you've hit them? Just any colour around that would be helpful.

Also, Dan, I think you mentioned on the opco capital side around derecognition. Were you just talking about legacy instruments just being derecognised through Basel 3 or is this more about potentially looking through into the future CRD and CRR and whether or not they may actually not count at all if the future as MREL?

And then finally, your liquidity metrics keep improving and you took down some TFS. I was wondering to what extent that might be temporary or a build-up of capital for something or whether or not you expect it to hold at a 149% LCR type level.

Dan Hodge, Group Treasurer

Okay, so let me take each of those in turn. In terms of the first one, I mean, obviously spreads are one of the factors that one considers in liability management exercises and obviously the tighter they go, all other things being equal, the less attractive they become from our perspective. We know these are a useful tool for investors and we obviously don't rule them out completely in the future and we don't comment on individual securities but we do consider a number of items in pursuing these. We include MREL eligibility, total capital eligibility, the up-front and ongoing profits and capital impact. Prevailing market conditions are important. Obviously don't forget we need a regulatory approval as well if it's capital.

In terms of the opco capital derecognition, really just referring to generally, we're aware of draft CRR2 / CRD5 proposals relating to terms needed for instruments to qualify as MREL and in some cases capital. It's possible that some of the existing opco debt capital ceases to qualify as such from 2022 but that very much depends on what the final rules say and whether there's grandfathering, as I answered just before with Lee's question, and it's pretty premature to conclude on that one in the meantime.

What I would just draw everyone's attention to is we do have a short tail of opco debt and capital and we've got about £8 billion or so maturing after 1st Jan 2022. Most of that's maturing shortly thereafter so there'll be a risk of non-qualifying on fairly low notionals.

Lastly on the LCR side, yes, obviously we have continued to increase our liquidity pool and the ratio itself has gone up. We're very happy with that, this has been very deliberate. We've strengthened our position further in preparation for, the tail end of regulatory structure reform, uncertain geopolitical macro outlooks and it's been achieved at a low cost. We've drawn down almost our entire entitlement to the term funding scheme at £10 billion in the first half. We've obviously got lots of additional money market funding as well.

Given the exemption for cash in the UK leverage ratio this is kind of neutral for our regulatory requirement. In terms of where we go in the future, we are happy at this level, we wouldn't expect it to change materially from here.

Greg Case, Morgan Stanley

Perfect, that's very useful.

Paul Fenner, Societe Generale

Hi. Thank you very much for taking my call. You guys are, I guess, pretty close to the conversations or representing UK banks in the Brexit negotiations. I just wanted to get a sense of what the mood music is at the moment and whether we're any closer to knowing whether or not we're going to shoot for regulatory equivalence and, what that means for your planning and whether that's something that you support.

And the second question is - on the issuance front I think you've done pretty well relative to where I understand your plans were for the full year so far in the first half. You say you're going to be a regular issuer. I just want to get a sense of, does that mean that it wouldn't be surprising to see you back in the market given where spreads are today in the markets in the second half of the year in tier two and/or AT1? Thanks.

Tushar Morzaria, Group Finance Director

Thanks, Paul. Why don't I cover the question around Brexit and I'll hand over to Dan to talk about your question on issuance levels. Yes, with regard to Brexit it's obviously a super-complicated situation and the forums that we've been invited to with the British government and other government officials; financial services is just one of the complexities that need to be dealt with but in some ways, while we're obviously very keenly into the complexities of financial services, when I sit in some of these forums it's sometimes even more intriguing to just see how even more complicated the situation is for other industries.

In terms of likely output and where we go from here, it's very, very difficult to say. I think from our perspective, we will assume the only thing we can assume which is some form of a cliff exit in April 2019 and be fully prepared for that in terms of ensuring operational connectivity with our clients and continuing to service them in all regards and I actually feel pretty good about doing that. As you know, we already have an Irish bank that is operational and licensed and we would look to further develop that to make sure we're ready.

Having said that, we do sense a very pragmatic tone from the UK government to try and come to a reasonable transitional period but unfortunately I suspect we won't know how successful they are until too late in the negotiations for us to handle it any differently. Dan, do you want to cover the second part of Paul's question?

Dan Hodge, Group Treasurer

Sure, yes, absolutely. Just by way of reminder, we've done just over 75% of our annual target for our TLAC so it leaves about two, 2.4 billion. Also I'll just repeat what I said on the call; that if conditions continue to remain pretty benign in the market and positive for issuance we may end up pre-funding some of 2018.

I like the way you put it actually; yes, absolutely, we'd expect some of that to be AT1 and/or tier two and also some more senior. You know, we will absolutely be a regular issuer over all those different security types.

Paul Fenner, Societe Generale

Thank you.

Lee Street, Citi

Thank you, I thought I'd take another one then. So on slide 12 you show your ratings and you make a comment about S&P and how they might approach the ring-fenced and non-ring-fenced bank. Do you think they will end up with Barclays Bank Plc remaining A- and the new ring-fenced bank being rated A or do you think it'll be the ring-fenced bank that will start at the A- and you'll see the remaining Barclays Bank Plc drop to BBB+? Any thoughts on that would be wonderful, thank you.

Dan Hodge, Group Treasurer

Well, obviously we'd certainly hope it should be at least the former if not better. I mean, the point about S&P; they've already taken structural reform into account with the rating of BB Plc and they have maintained it at A-. They've also said they would expect the ring-fenced bank to perhaps be much higher so I think we're fairly confident about it being that at worst although it's not something we control.

So we therefore focus absolutely on what we can control, given that they are independent, they form their own views so we think that our strategy is very credit-supportive so we're aligned with the agencies' view. We really need to focus on getting our returns up above the 10% target over time and continue with our holdco issuance, which is pretty helpful for certain of our ratings, and just to navigate the end of structural reform.

I think in terms of BB Plc. the reason why it is where it is still is because it's a very robust entity. The design of structural reform for us was very much making sure that both the ring-fenced bank and the non-ring-fenced bank continue to be very strong, very robust, diversified by product and geography and funding sources. Certainly if the credit spreads are anything to go by we're getting a bit of a thumbs-up on that front so far from the market.

Lee Street, Citi

Very clear, thanks very much.

Robert Smalley, Citi

Hi, thanks a lot and again thanks for doing this call in US hours. A few things; one, I'm a little confused on the net interest margin going forward. You talked about better funding costs. I'm assuming that you'll have more favourable development versus deposits as well but it seemed to be flagged that there would be a decline in the second half. I'm not clear why; that's my first.

Second, on cards development; I know here in the States we're starting to see problems tick up, not only with the greater amount of consumer indebtedness; collections have become a little bit more difficult when borrowers start to go bad. What experience have you had and what are you seeing and how are you planning for that further?

And then finally the 10% RoTE target; I'm assuming this is equal to your cost of capital. Could you just address the question, as a creditor, how do we feel comfortable around this kind of target if you're just making your cost of capital and that's your goal?

Tushar Morzaria, Group Finance Director

Thanks, Robert. Why don't I take them? In terms of your first question, net interest margin, the comment there was really for the UK. We guided originally to about a 360-basis-point net interest margin in the UK and in the second quarter our net interest margin nudged up actually from above that level in Q1 to 370 basis points in Q2.

We do expect that to come down somewhat but we do expect on a like-for-like basis our UK net interest margin to be greater than 360 basis points over the full year. The reason for the slight decline on a like-for-like basis is we do expect our mortgage book to grow very modestly. We are seeing very healthy inbound applications and we do like low-LTV product and margins there. They are quite competitive but still very accretive to us so very modest increases in our overall mortgage book over the course of the remainder of the year will put modest downward pressure on net interest margin but, as I say, like-for-like still greater than 360 basis points.

And the reason I've stressed like-for-like is that - and you're probably also aware that we've closed our non-core units at the end of this second quarter. As a result of that the remaining assets are passed back into, if you like, their home businesses. One of the assets that will find its way back to the UK bank are super-long-dated sterling loans, fixed-rate loans or what we call our ESHLA portfolio; education,

social housing and local authority lending. Those have lower margins and so there'll be a dilution simply because of those assets going back into the UK bank.

And on an annualised basis that's like [40] basis points so you'll see our third quarter reported net interest margin in the UK bank obviously dip down but, as I say, it's really on a like-for-like basis just a modest decline due to a mortgage reduction.

Your second question on card impairment; we've actually found our delinquency rates pretty stable, both in the UK and in the United States. In the UK actually delinquency levels ticked down a little bit so from very low levels they've improved in that sense and when we look in our credit metrics it's hard to see signs of stress unless you go right to the low end of the credit spectrum, which really isn't a meaningful part of our business.

In the US it's a slightly different story but the trend in terms of stabilising delinquencies are perhaps even slightly improving, it's just that we've had a tick-up in terms of US delinquencies, which I think most US banks saw early on in the first quarter, and then somewhat stabilising.

In the UK we have been pretty cautious on our outlook and therefore have really not changed our risk appetite for the last several years in terms of the kind of risks that we seek, so we haven't really looked for higher-margin products in the secure space whether that's interest-rate-only mortgages or first-time buyers or high LTVs or even trying to materially increase our market share of buy-to-let lending; it's not something that's been a huge priority for us.

In the US it's slightly different because the lending that we do on the consumer side is mostly through the partnership business that we have in our card portfolio so the kind of customer cohort is somewhat driven by the retailer or the partner that we're in.

Most of our partnerships tend to be for the higher end of the credit spectrum; the airlines for example typically exhibit very strong customer FICO scores but we do have a mix, for example, our Apple portfolio. We run the Apple rewards card; that has a greater spread of FICO scores.

We have been in the UK increasing staffing in our collections department, somewhat not really anticipating a call on the economy or a macro slowdown but just sort of consistent with our prudent risk appetite we do want to make sure that we can be as pre-emptive as we can in terms of any stress that may or may not arise in the UK.

And then finally your question on 10% return; we did say greater than 10% and our objective is absolutely to be generating a return that's above our cost of capital. It’s hard to know what that is. Our expectation is that as the bank becomes steady-state, as regulation becomes steady-state and bank earnings become more predictable we would expect there to be some downward pressure on the pot of capital. What there will be will be obviously for others to decide, our equity investors rather than ourselves, but we think that a greater than 10% return is realistic, but with the right ambition and is achievable.

A 10% return for us would require something like close to £5 billion of attributable profit. A a simple bridge to see how close we could get there just on the current earnings is if you take our 2016 reported profits, statutory profits, they were 1.6 billion. Included in there were some legacy conduct items; they totalled £1.4 billion and I would add that back. Also included in there was an attributable loss from our non-core businesses of £1.9 billion; you could add back a reasonably material portion of that. And then there was of course some various other restructuring charges; costs for building our ring-fenced bank, etc; you can add back two or £300 million comfortably there.

That on a very quick calculation gets you to somewhere around £4.5 billion of attributable profit just on 2016 underlying performance and that'll give you a greater than 9% return on tangible shareholders' funds so that still requires some work to do obviously but we don't think this is unrealistic and it obviously wouldn't stop there, we'd like to ensure that the bank can operate at greater than 10%, at the right time.

Robert Smalley, Citi

Understood. Thank you for the answer and thanks for the depth on all of them, appreciate it.

Tushar Morzaria, Group Finance Director

Okay, well, thank you very much for joining us. We do hope you found this call helpful. Do please give us any feedback on anything else you'd like to hear; talk either to Dan directly or to our investor relations. Otherwise I'm sure Dan and the team will see you on the road over the next few days.

Dan Hodge, Group Treasurer

Thank you.

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