Barclays PLC FY 2018 Results

Fixed Income Conference Call Speech

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Kathryn McLeodland, Group Treasurer

Slide 2: Tushar Morzaria, Barclays Group Finance Director

Good afternoon everyone and welcome to the fixed income investor call for our full year 2018 results.

I’m joined today by Kathryn McLeland, our Group Treasurer, as well as Miray Muminoglu, our Head of Capital Markets Execution.

Let me start with slide 3 and make a few comments on our full year performance before handing over to Kathryn.

Slide 3: FY18 Group highlights

Our 2018 results demonstrate the progress we are making towards achieving our Group financial targets, in particular our RoTE targets of greater than 9% and greater than 10% in 2019 and 2020 respectively.

We reported an 8.5% Group RoTE, excluding litigation & conduct. This improved performance on prior year was driven by a year on year increase in PBT of 20% to £5.7 billion, with lower costs driving positive cost to income jaws.
Impairment was 37% lower in 2018 at £1.5 billion, reflecting updates for consensus-based macroeconomic forecasts in the US and UK during the year and the prudent management of credit risk. The UK economic environment continued to be benign, with delinquency rates remaining at low levels in UK cards.

Despite this, in Q4 we took a £150 million specific impairment charge to reflect the impact of the economic uncertainty in the UK. In addition, as we have said previously, our bias remains to grow the secured lending book over the unsecured lending in the UK.

With this economic backdrop and conservative positioning, Barclays UK reported a RoTE, excluding litigation and conduct, of 16.7%, underpinned by prudent mortgage balance growth of £4.4 billion year on year and continued focus on our digital agenda, growing digitally active customers to 10.8 million at the year end.

The RoTE of Barclays International nearly doubled to 8.7% in 2018, within which the CIB RoTE increased 490 basis points to 7.1%. We acknowledge that we have work to do to further improve the CIB returns, but the actions we have taken over the last five quarters, through the talent, technology and capital redeployment initiatives we have undertaken have enabled us to improve market share.

This is evidenced by the 50 basis points of market share growth we attained across our Markets products, which led to a year on year income print which compared favourably to our peers.

Consumer, Cards and Payments printed a very strong 17.3% RoTE for 2018. US card net receivables increased 4% on an underlying basis year on year to $26.9 billion and we have been particularly pleased by the growth in our American Airlines and JetBlue prime partnership balances, which have seen double digit growth.

Turning now to slide 4.
Slide 4: Focused on profitability and capital targets

One of the key achievements of Barclays in 2018 was the successful stand-up of our UK ring-fenced bank on 1 April. We were the first UK bank to execute on our plans, nine months ahead of the regulatory deadline, which was a testament to our strong execution capabilities.

Having completed the restructuring of the bank and resolved significant legacy litigation and conduct matters in the first quarter of the year, the bank was well positioned to deliver improved operating performance, and retain more of the significant capital the bank generates from profits – 140 basis points in 2018.

We maintain our Group financial targets, which are outlined on this slide.

And with that, I'll hand you over to Kathryn, who will provide a comprehensive update on our capital, funding and liquidity positions, as well as other areas of particular interest.

Slide 5: Kathryn McLeland, Group Treasurer

Thank you Tushar and to everyone for joining today’s call.

Slide 6: Strengthened financial position across key metrics

This improved financial performance we delivered in 2018, with profits up 20%, was achieved whilst maintaining very robust balance sheet metrics.

We prudently managed the Group’s capital position, ending the year with a CET1 ratio of 13.2%, at our target of around 13%.

We continued to make strong progress towards our expected 1 January 2022 MREL requirement, issuing over £12 billion of MREL eligible debt from our holding company, across a variety of currencies and tenors over the course of the year. This
resulted in a HoldCo MREL ratio of 28.1% at the year end, comfortably above our 2019 and 2020 requirements.

And finally our liquidity position remained a key credit strength for Barclays, with a year end LCR of 169% and a liquidity pool of £227 billion, representing approximately 20% of the Group’s total balance sheet.

I will go into each of these areas in more detail shortly, but before I do so, I wanted to touch on one of the 2018 highlights – our performance in the Bank of England and Fed stress tests.

We passed our first public CCAR for the US IHC at the end of June, on both a quantitative and qualitative basis, which was testament to the careful capital planning for this entity since it was established in 2016.

Also reassuringly, our 2018 Bank of England stress test CET1 ratio drawdown was 100 basis points lower than last year. This is evidence of the de-risking the bank has achieved in recent years and the benefit of having resolved significant legacy litigation and conduct issues.

The Bank of England stress test results also highlight our resilience to a severe adverse stress scenario across our key markets, and is further evidence that we are well positioned for Brexit and other macro stresses should they occur. The Bank of England highlighted that the 2018 UK stress scenario was more severe than their disruptive and disorderly Brexit expectations.

Our conservative credit risk positioning and these robust capital, funding and liquidity positions, provide reassurance that we have the resilience to withstand UK, US and global economic shocks.

I will begin by looking at the Group capital position, which you can see on slide 7.
Slide 7: CET1 ratio progression

At the end of 2013 the Group’s CET1 ratio stood at 9.3%. During the four-year period to the end of 2017, Barclays’ CET1 ratio accreted 400 basis points to 13.3%, achieving our target of around 13%.

This afforded us welcome capital flexibility in 2018. As a result, our Group CET1 ratio remained broadly stable over the year, ending at 13.2%. There were, however, many moving parts during the year, including the resolution of a number of headwinds.

Importantly, the Group is highly capital generative. We generated £4.2 billion, or 140 basis points, of underlying profits.

This profit generation was partially offset by a £2.1 billion, or 71 basis points impact as we resolved significant legacy litigation and conduct headwinds. This included the settlement of the US DOJ RMBS litigation for $2 billion in Q1 of 2018, which we had always said was the most material litigation matter to put behind us.

We would expect these headwinds to be substantially reduced going forward.

The Group’s profit generation enabled us to pay a total dividend of 6.5 pence for 2018 and redeem legacy capital instruments - a combined £2.2 billion capital impact from these actions.

These redemptions included the $2.65 billion 8.125% legacy retail preference shares and the call of our first HoldCo $2 billion 8.25% AT1 security, which will result in an ongoing earnings benefit, albeit at an upfront impact of 33 basis points of CET1, as these instruments were held on the balance sheet at historic FX rates.

The updated capital management framework we outlined today acknowledges our commitment to maintaining an appropriate balance between maintaining a strong capital position for bond holders, total cash returns to shareholders and investment in the business.
Turning now to slide 8, where we recap how we think about our capital requirements, and why 13% is the appropriate CET1 ratio for Barclays

**Slide 8: Strongly capital generative and at target CET1 ratio**

As you will have heard from us before, we manage our CET1 ratio considering a number of factors.

First and foremost, and importantly for our bondholders, we need sufficient headroom above the distribution restrictions minimum. With our MDR at 11.7%, this currently affords us a headroom of 150 basis points to our year end CET1 ratio of 13.2%.

The second factor is the ability to pass stress tests – both Bank of England and our own internal stress tests.

In the 2018 Bank of England stress test, Barclays’ drawdown was 440 basis points, to a low point of 8.9%. This afforded us headroom of 100 basis points to the 7.9% hurdle rate – a comfortable pass.

The 440 basis point drawdown included around 40 basis points relating to the now settled US RMBS litigation. Excluding that charge, the drawdown was 100 basis points smaller than the drawdown in the prior year’s test.

This drawdown was also lower than our major UK peers. This reduced sensitivity to stress demonstrates the de-risking activities undertaken in recent years, and the significantly reduced legacy litigation and conduct headwinds.

When we also compare our CET1 ratio target against that of our US and European GSIB peers, at 13.2%, our CET1 ratio is in line with the US peers’ average of 13.1%, and above the European peers’ average of 12.2%.

The Bank of England’s comments about the UK banking system being resilient to deep, simultaneous recessions in the UK and broader global economy, as well as the
permission we received to redeem the preference shares and AT1 in December, should provide additional reassurance to investors.

Finally, we also consider of course the PRA buffer, which is informed by the BoE stress test results, when assessing our CET1 ratio target.

So, in summary, considering these factors, we believe that around 13% is the appropriate CET1 ratio for Barclays, both from a risk perspective and enabling us to execute on our strategy.

A brief comment now on leverage, which we continue to see as a backstop capital measure.

At year end, the UK leverage ratio was 5.1%, unchanged from year-end 2017, and well in excess of the 4% minimum UK requirement applicable from the beginning of this year. This represents a surplus of around 150 basis points to the 2018 Bank of England stress test hurdle rate of 3.6%.

As a reminder, for consolidated leverage requirements, we currently need to comply only with the UK regime, which exempts cash held with central banks. And of course the year-end ratio remains the starting point for stress tests.

We will closely watch how the PRA looks to implement the CRR2 standard on leverage. However, based on what we can see, we still view the risk-based RWA measure as the primary capital measure for the Group.

Slide 9: Strong legal entity capital positions

As we have said previously, the CET1 ratio for the Group of around 13% accommodates the capital requirements of all of our key legal entities.

As you can see on slide 9, at year end, Barclays Bank UK PLC, or BBUKPLC, and Barclays Bank PLC, or BBPLC, printed transitional CET1 ratios of 14.2% and 13.5% respectively.
Consistent with the Group, we view the risk-based RWA measures as the binding constraint for both legal entities. And, while they are not currently subject to leverage requirements, the legal entities do have CRR leverage ratio disclosure obligations, which were 4.9% and 4% for BBUK and BBPLC respectively at year end.

For the US IHC, capital continues to be regulated on a standalone basis by the Fed and the required levels of capital are largely driven by the CCAR stress test outcomes.

Management of legal entity regulatory requirements has been fully embedded in our capital and leverage planning for some time.

Subject to appropriate governance, we expect excess capital in the respective legal entities to be upstreamed to the holding company, where the Group will decide how and where best to deploy it.

Before moving onto MREL, I wanted to remind you of how we think about the other elements of the CRDIV capital structure – in particular AT1 and Tier 2, which you can see on slide 10.

**Slide 10: Transition to CRD IV capital structure well established**

As you know, we are incentivised to hold at least 2.4% of RWAs in AT1 form, reflecting the current Group Pillar 1 and Pillar 2A capital requirements allowable in this form.

However, as we have said before, we intend to maintain headroom to the 2.4% to accommodate variability in both RWAs and FX, including under stress. AT1 capital also has a secondary benefit in contributing to our leverage ratio. When we consider these factors, we believe it is appropriate to maintain the AT1 component around the current level.

We also consider our call profile when assessing the appropriate level of AT1, and as you will be aware, whilst we cannot make any specific comments on our intention
to call AT1s or otherwise ahead of time, I thought it would be helpful for us to outline the factors we do consider when making these decisions.

Our existing call policy still stands in that each decision will be made on a case by case basis, considering the economics in the round at the time. These economic factors include:

i. Direct earnings implications around the refinancing, considering the relative cost of issuing AT1 at prevailing market levels;

ii. The impact on our broader wholesale funding including cost and capacity; and

iii. The day 1 capital impact on redemption of non-Sterling AT1s, due to the FX impact on redemption from rebasing the value of the bond to current FX rates.

In addition, we consider our forecast capital position, and of course we require PRA approval to redeem any capital instrument.

Considering now our Tier 2 securities. We are incentivised to hold at least 3.2% of RWAs in this form, and again we intend to maintain headroom to this 3.2% level.

While we are comfortably above that ratio at 3.7% on a transitional basis, £5 billion, or over 40%, of this Tier 2 is OpCo issued debt. Hence, you would expect us to continue to issue HoldCo Tier 2 as OpCo Tier 2 reduces over time.

There has been much discussion on legacy OpCo Tier 1 and Tier 2 capital resulting in an MREL add-on for issuers should it be outstanding post 1 January 2022.

As we have highlighted previously, our legacy capital tail post 2022 is modest and short-dated, with nearly 95% of that tail maturing by the end of 2022. We therefore do not view this as a concern for Barclays.

Finally, we note the conclusion of the EU banking reform package, and the future capital eligibility provisions appear manageable for our legacy OpCo stack.
Slide 11: Continued progress in HoldCo issuance whilst diversifying the markets we access

As you can see on slide 11, we remained active in the debt capital markets throughout 2018, issuing £12.2 billion equivalent from the Holding Company, similar to the volumes of the past two years.

£10.2 billion of that was in senior debt form, with £1.9 billion in AT1. This compared to £2.4 billion of maturities and redemptions from the HoldCo during the year.

We were pleased with the currency diversification of our HoldCo issuance in 2018 – as we issued around 14% in non-G3 currencies. We successfully issued public benchmark transactions in Australian dollars, Japanese Yen and Swiss Francs. In addition, we executed private placements in Swedish Krona and Norwegian Krona.

We value this currency diversification and the ability to attract new investors and we expect to continue issuing in these currencies in the future, while also considering other currencies.

Slide 12: Successfully transitioning to HoldCo funding model

On slide 12, you can see the strong progress we have made over recent years in our MREL issuance.

At the end of 2018, our MREL ratio was 28.1% on a HoldCo basis, and 30.5% on a transitional basis – in excess of the 2019 and 2020 interim requirements, as OpCo legacy capital continues to qualify until 2022.

We currently expect the Group 1 January 2022 requirement of 30% of RWAs to be our binding constraint.

We expect to hold a prudent headroom above this minimum requirement, and remain confident in being able to achieve our MREL targets.
With that in mind, we are now expecting around £8 billion equivalent of gross HoldCo issuance in 2019. Senior debt will naturally account for the largest share, but as I mentioned previously, we also expect to be a regular issuer of both AT1 and Tier 2. As ever, the timing of our planned issuance will be subject to market conditions and investor appetite.

As you can also see on this slide, we have approximately £11.6 billion of HoldCo and OpCo debt maturing or callable in 2019.

Finally, as we have said many times, we expect our term debt with tenors of three years and out to be issued from the Holding Company. This is driven by the single point of entry funding model being the preferred resolution approach of the PRA, and therefore HoldCo funding is a requirement to qualify as MREL.

Term debt with tenors of three years and in are likely to be issued out of the operating companies on a more opportunistic basis, given the very diverse funding profiles of our operating companies, which you can see on slide 13.

**Slide 13: Diversified Funding Sources across all legal entities**

To put the scale of the HoldCo MREL funding into context, at £49 billion, it represents only 8% of our total Group funding sources. This £49 billion is then predominantly downstreamed to BBUKPLC and BBPLC commensurate with their RWAs, and in line with the requirements set by the Bank of England.

The downstreamed MREL remains a small proportion of the overall legal entity funding.

The funding sources of these two entities are both very well diversified, including strong and stable deposit funding.

Whilst deposit funding will remain the mainstay of BBUK’s funding base, we have an established covered bond programme, having successfully issued a £1.25 billion
transaction in 2018. We also have active Gracechurch cards and RMBS securitisation programmes and completed a $650 million issue from the Cards programme in 2018. We expect to remain active in these programmes, and to supplement them with short-term operational funding when required.

Similarly, BBPLC’s funding base comprises a diverse mix of deposits from the Corporate, Private Banking and US consumer businesses. The entity also benefits from residual outstanding BBPLC issued senior debt and capital. Funding is also provided by the Dryrock cards securitisation programme, from which we issued $650m last year, alongside very well established programmes for issuing structured notes, shorter-dated senior transactions, CD and CP, for operational funding purposes.

It is important to highlight that late last year we updated the documentation associated with our internal MREL funding arrangements to downstream HoldCo debt on a subordinated basis to the legal entities. This enabled us to be compliant with the Bank of England’s internal MREL requirements by the 1 January 2019 deadline.

Turning now to liquidity.

Slide 14: High quality liquidity position

Slide 14 shows the growth in the Group liquidity pool to £227bn by the end of 2018, representing more than 20% of the Group’s total balance sheet. And, it’s composition remains conservative.

This translates into a Pillar 1 LCR of 169% and represents a surplus of £90 billion to the 100% requirement, comfortably above the peer average of 138%.

As I have said before, the quality and quantum of our liquidity are inexpensive credit strengths and we are minded to run at these high levels of liquidity during this period of macro-economic and political uncertainty.
The £227 billion pool splits between BBUKPLC and BBPLC and the respective pools are sized at £45 billion and £182 billion. These contribute to an LCR for BBUKPLC of 164% and a Domestic Liquidity Group LCR for BBPLC of 147%.

You can also see on this slide that the proportion of customer deposits within our overall Group funding profile, and the resulting loan to deposit ratio of 83%, has remained very stable.

We have continued to reduce our reliance on short-term wholesale funding, with only £47 billion, or 30%, maturing in less than one year.

As a result, the Group liquidity pool at year end exceeded wholesale funding maturing in less than one year by £180 billion.

**Slide 15: Preparation for continuity of business in the event of Brexit**

Our preparations to ensure continuity of business with European clients in the event of Brexit at the end of March are also well advanced, as we have summarised on slide 15.

Barclays Bank Ireland, or BBI, in its expanded form is the vehicle which will provide passported activity for EEA-domiciled clients post Brexit.

In October last year, we received Central Bank of Ireland approval to proceed with our expansion plans. In its expanded form, BBI will be regulated by both the Central Bank of Ireland and, given its size, the ECB under the Single Supervisory Mechanism.

We have been engaging with our EEA-domiciled clients on our Brexit plans since Q2 of last year, including plans to establish their relationship with BBI.

All new business from these clients will be conducted from BBI from the end of March and, while we are assuming some balance sheet related to these clients may be retained in BBPLC, many clients have expressed the intention to consolidate their counterparty relationship in BBI.
Migration of client contracts and positions will be executed using a combination of consensual negotiations and a Part VII legal transfer. This is similar to the scheme we used for the creation of the UK ring-fence bank in April last year.

At the end of January, we received High Court approval to execute the transfer of business to BBI under a Part VII court order. This will enable us to duplicate or transfer contracts currently in place with BBPLC to BBI rather than requiring clients to sign new documentation.

The process will take effect over a period of just under 6 months from 1 February 2019, with the transfers being staggered over a series of dates so as to minimise disruption for EEA customers, clients and counterparties.

As part of our plans, all of the existing EU branch network and associated positions that have historically rolled up under BBPLC are being transferred to roll up under BBI, but the entity remains a wholly owned subsidiary of BBPLC.

We have completed the migration of three branches to date, with the remaining four branches due to be migrated shortly. Following these migrations, BBI will consist principally of the current Corporate, Investment and Private Banking activity across Europe, and the Barclaycard consumer business in Germany.

The credit ratings of BBI are aligned to BBPLC – at single A+ with Fitch and single A with Standard & Poor’s.

On this slide, we have also updated the illustrative pro-forma financials of BBI in its expanded form, which we have refined following the client outreach we have conducted.

To give you a sense of size of the expanded entity, the pro-forma financial information is shown as at 2018 year-end, taking EEA-domiciled client positions at the time, and assumes our current estimate of migrated business. This would have
resulted in an end state external balance sheet of just under £160 billion – less than 15% of total Group assets.

Pro-forma BBI revenues for 2018 would have been less than 10% of the Group.

BBI’s shareholder’s equity would have been around £5 billion and we expect BBI’s capital ratios will be broadly in-line with those of BBPLC and the Group.

The funded balance sheet would have been £34 billion. The balance sheet will be funded by a diverse mix of Corporate, Private Bank and Barclaycard customer deposits, a mix of short and long-term sources of wholesale funds, and internal MREL and equity provided by the Group.

These funding sources will also ensure the entity has strong liquidity metrics.

With just over a month until the UK is due to leave the European Union on 29 March, we expect to be fully operational ahead of this time, although of course we continue to monitor the progress of the political negotiations which may result in changes to the current timelines and allow further time for our clients and the industry to restructure their operations.

Before I conclude, I will quickly summarise the current key ratings of the Group on slide 16.

**Slide 16: Ratings remain a key priority**

Standard & Poor’s assigns a long term rating to Barclays PLC of BBB. BBUKPLC and BBPLC both have single A ratings, which reflect the “core” status of both entities under S&P’s methodology. Each of these entities have stable outlooks.

Fitch assigns a long term rating to Barclays PLC of single A. BBUKPLC and BBPLC were upgraded by one notch in December to single A+, due to there being sufficient pre-placed MREL within the entities to receive one notch of Qualifying Junior Debt. As with S&P, each of these entities have stable outlooks.
Finally, Moody’s assigns a long term rating of Baa3 to Barclays PLC. BBUKPLC is rated A1 and BBPLC is rated A2, with each of these entities again on stable outlooks.

As we have said before, ratings are strategically important to us. They are a significant focus of senior management, and, as you would expect, we have a regular and close engagement with each of the rating agencies.

We continue to focus on the successful execution of our strategy, to strengthen our credit proposition, and therefore improve our ratings profile over time.

In terms of the implications of Brexit on our ratings, each of the rating agencies have signalled that an “orderly” Brexit is assumed in their current ratings. However, even under a “no deal” scenario, our geographical diversification should provide some mitigation for the Group’s ratings from UK macro driven downwards rating pressure.

Slide 17: Q&A

So to conclude, my Treasury priorities for 2019 are split into two key areas. The first is to maintain the robustness of the Group’s balance sheet, given the uncertain political and economic backdrop. This includes managing the Group’s capital position around our target CET1 ratio of 13%, continuing to build our MREL funding position, with a plan to issue around £8 billion equivalent from the HoldCo in 2019, and running a prudent liquidity position.

The second is to support the Group in the achievement of its financial targets.

Tushar, with that, I’ll hand back to you.

Thank you Kathryn. I hope you have found this call helpful. We would now like to open the call up to questions.
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Subject to our obligations under the applicable laws and regulations of the United Kingdom and the United States in relation to disclosure and ongoing information, we undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise.