Barclays PLC Q3 2019 Results

25 October 2019

Results call Q&A transcript (amended in places to improve accuracy and readability)

Alvaro Serrano, Morgan Stanley

Two questions from me. Obviously you had a very strong quarter, in CIB in particular, I was just interested if you can give us a bit more colour about the competitive environment during the quarter? You mentioned in the last call you had gained $20bn of assets from Deutsche, but some of your competitors have been calling out Europe as being quite tough, so maybe you can give us a sense, how things are evolving, and a sense for the pipeline?

Despite the revenue beat and things being quite solid, you’ve cautioned around 2020, so maybe could you reflect on that as well? What divisions are you particularly worried about where visibility is lower now than you anticipated before?

Jes Staley, Group Chief Executive Officer

On the CIB, it was a good quarter for us, particularly in the M&A advisory and debt underwriting side, where we think we’ve landed the strongest third quarter in the history of the bank. There’s always a degree of volatility in the Markets business. We did reasonably well in FIC. We’d still like to be doing stronger in Equities than we are right now. The fourth quarter last year, as everyone recalls, had a very tough end of December, and you can’t count that out again.

We feel good in terms of the market share gains. We continue to see gains in prime brokerage, both on the equity side and the fixed income financing side. Let’s see how we compare with the European peers as they report next week, but all the dialogue we had with the buy side is quite good. There are still certain markets where volatility is at very historic lows, and obviously we’d love to see, in the course of 2020, a more normalised level of movement in the financial markets.

The comment that we’ve put in our release this morning is just being realistic about the operating environment that we think we’ll be entering into as we get into 2020. You’ll recall when we set our targets in the third quarter of 2017, obviously a lot has changed since then. Things I’d call out – the rate environment is obviously significantly lower than we would have thought, we’ve also been taking a relatively defensive posture on unsecured credit in the UK, growing our mortgages business more rapidly relative to unsecured credit, so I would expect that to be reflected in our net interest margin, coupled with the low-rate environment. I think it’s just where we are.

Obviously, famous last words, but we didn’t expect Brexit to still be ongoing. What does that do for our business? It does create some uncertainty, particularly in our traditional banking businesses, so you’ll see that liability balances actually have been growing quite nicely, but there’s less demand for credit than we
would have anticipated. You can see that, for example, in Business Banking, Corporate Banking, and indeed, consumer credit. 

So I think a combination of lower asset growth as we get into 2020, a more difficult rate environment, and perhaps a bit more uncertainty as to the path of the macro-economy. It’s just a dose of realism. We think we have a good, diversified business. In some ways, the 9% and 10% [RoTE targets] are important to us, but perhaps what’s more important to us is sequential profit growth, and that’s something that both Jes and I are very focused on.

Jonathan Pierce, Numis 

I have two questions on the CIB. The first question is the comment around the £90m of net benefit from treasury sales and counterparty credit risk hedging. Can you give us a flavour as to what the gross components of that were? The reason for the question is the value in your OCI reserves fell by over £200m in the quarter, despite bond yields going down, so I’m just wondering whether actually the treasury gains were really quite large, and then there’s a big negative in the other direction on counterparty credit risk hedging. If that’s the case, what exactly is this hedging CCR issue?

Second question is just to get a bit more colour around the movement in CIB risk-weighted assets in the quarter. They were up about £9bn. Can you give us a sense as to how much of that was FX-driven? It also looks like there were some model and methodology changes in the quarter that were quite big as well. I’m really trying to get to the bottom of the extent to which the book itself, the book size, has driven up CIB as opposed to other issues like FX and model changes?

Tushar Morzaria, Group Finance Director

On the £90m benefit that we called out, we find it useful to try and isolate the non-recurring items for the year. I think there are three [non-recurring items in Markets] this quarter - Tradeweb, treasury gains given the very strong rally in rates that has reversed already in Q4, and counterparty credit risk hedging, or CVA hedging as a lot of people know it as. You are right that the Treasury gains [and CVA hedging] are obviously reasonably well offsetting. We haven’t disclosed what those Treasury gains are, but they are meaningful.

If they were that significant, I think I would have called them out in the release. So I won’t throw out a number on the call, but you’re right that the Treasury gains were larger than the losses on Counterparty Credit Risk hedging, but if they were that significant, I would have called them out.

Jonathan Pierce, Numis

Just to follow up, do you think that will be a negative then in the fourth quarter, in terms of the combination of those two? I guess it will just be Treasury losses in Q4?

Tushar Morzaria, Group Finance Director

It depends on the rate environment and a whole bunch of factors. At the moment, rates have backed up a lot. I guess look at it in a glass half-full way. If we were able to take some gains in Q3 as rates rallied then add that back into our liquidity pool as rates sold off, that turns out to be quite fortuitous for us, because obviously the carry on the liquidity pool will show up in subsequent quarters. It’s just way too early to be extrapolating for those things.
You had a question on the Counterparty Credit Risk. It’s nothing cleverer than we have a whole bunch of counterparty credit risk out there, from both collateralised and uncollateralised counterparties, and we need to manage the risk effects of that. That does get harder, particularly when forward rates in euros go negative, that becomes quite hard to hedge, so it’s just some of the effects you have in a low-rate environment.

On risk-weighted assets in the CIB, the table that we have in the disclosures is there, but it doesn’t really do a great job of stripping out the FX component. You’ll probably see that in our footnotes there, but to try and be a little bit more helpful, I’d say half the growth in CIB came from [model and methodology changes]. The other half I would put in a combination of a little bit of book growth and FX that you have as we closed the quarter at the end of September. FX has obviously moved quite a bit since Q3, so that will be what it will be. It will probably move the other way, certainly at these rates.

Perhaps a more helpful measure for focus is what was the average RWAs through the quarter, and that was [mostly] a bit lower than the spot print that you have there. So very modest period-end book growth, but I’d put that into the regular characterisation. I don’t think there’s anything, A, significant and, B, perpetual there. It’ll ebb and flow as trading activity changes.

Joseph Dickerson, Jefferies

On the net interest margin in the UK, was the benefit quarter on quarter primarily from funding costs coming down, and therefore that’s what is guiding the commentary around the Q4 movement?

Secondly, just coming back to the caveats around the ability to deliver on the RoTE targets, [...]how would you think about them in a lower-for-longer environment? And I suppose certainly part of your business may be impacted by whatever the Bank of England does or doesn’t do post-resolution of Brexit, but how would you think about pacing things like investment spend and variable compensation? Because I noticed the quite robust performance in the investment bank in the quarter, so how would you think about those two dynamics in terms of attempting to deliver on the RoTE aspiration for next year?

Tushar Morzaria, Group Finance Director

The movement in net interest margin I wouldn’t say was funding costs so much in Q3. You may recall in Q2 we made an adjustment to reflect the customer behaviour that we’ve been seeing, particularly in the mortgages businesses. We’ve seen customers refinance at much quicker rates, and refinancing into longer fixed products. So we reflected that sort of catch-up, if you like, to actual customer behaviour, resulting in a slightly lower NIM in Q2 than you would have had on an underlying basis. I would say that’s probably the bigger delta from Q3 to Q2. Some people may have just not picked that up.

In Q4 though [...] if we are to hold NIM close to these kinds of levels, they will probably be a touch down, but I would expect Q4 NIM to be lower than the Q3 headline number. Now, what’s driving that? There are really two aspects that I’d call out there that we can see at the moment. One is that we continue to grow our secured book relative to our unsecured book, so just the maths of a lower-margin product growing at a quicker pace than a higher-margin product. And the second thing is we have seen a very deliberate decrease in our interest-earning balances in the cards business, and I expect that to continue to roll into Q4 as we continue to position ourselves in the right way for that business. So I think a combination of those two factors will lead to a lower Q4 NIM, but over the full year, it’ll be probably a touch lower than what we’ve had for Q3.
Jes Staley, Group Chief Executive Officer

The lower for longer environment I think makes it challenging for the financial industry, whether it’s a bank or an insurance company, particularly if the yield curve is flattening. One of the realities, whether you’re a European bank, a UK bank or a US bank, we all have to manage very sizeable liquidity pools now, and those liquidity pools basically get trapped in those low interest rates, and obviously that’s going to have an impact on your performance.

In Europe, you’ve got negative interest rates, and that is particularly acute for the European banks. The ten-year rate here is well below 100 basis points, so that has an impact, and we wish we had the ten-year rate they have in the US. On the other side of that, however, low interest rates, on one level, should help the outlook for your credit environment, and so as you look at impairment, particularly in the small business and corporate side, those lower interest rates can translate into improving your provision line.

Then, the ultimate question I think for all of us is, if we are facing economic headwinds in Europe and possibly in the US, is there going to be a fiscal response in Europe the way you’ve seen the fiscal response in the US? So that’s one of the things we’re looking at, in addition to obviously hoping to get the Brexit uncertainty behind us. But a lot of the headwinds that we talked about for the 10% [RoTE] target for next year is much more focused on the UK, the Brexit uncertainty and the interest rate environment here, particularly versus the environment when we set this target in the fall of 2017.

On the other side, we hope that the diversification of our business model, the sizeable position we have in the US, both in the US consumer business but particularly in the IB, can lead to currency playing in our favour. So there are pros and cons, but we did want to leave a degree of caution for next year.

Joseph Dickerson, Jefferies

On the point that you made on liquidity, it’s just a macro-level point on the need to hold liquidity, it seems that is part of what is exacerbating the repo market in the US and prompting the Fed to have to act. Is there any way that that is impacting your business?

You have an incredibly liquid balance sheet, particularly relative to some of the other primary dealers. Is that providing any opportunities for you in terms of market-making in the US?

Jes Staley, Group Chief Executive Officer

We have a very sizeable repo book in the US, I think we’re one of the largest banks in that market, and all I’ll say is, obviously no one likes to see a market like that break out the way it did for those two business days, but they were actually quite active for us. We stayed in the repo market quite strongly, and were there to provide financing for clients that needed it.

Tushar Morzaria, Group Finance Director

The only other comment I’d make on that is we probably don’t have the G-SIB pressure that maybe some of the money-centre banks in the US have called out in recent times, so that probably makes it a little bit easier for us to navigate through that.

Ed Firth, KBW
Can I just ask about your international consumer business, and particularly some of the credit metrics, I’m just trying to square your comments about optimism in that market and in that sector. When I look at your credit metrics, the actual underlying dynamics looks to have deteriorated, certainly Q3 versus Q2. And if I look at your coverage ratio, you’ve let your coverage come down Q3 versus Q2, certainly on your stage 3 assets. We’ve got a challenging environment, it’s an overseas market which intuitively one imagines one’s not as close to. I know that’s probably a little bit unfair, but also it’s an area you’re growing at the same time as credit seems to be deteriorating, and I’m just trying to square all those factors, if you could help me there?

Tushar Morzaria, Group Finance Director

The impairment charge, sequentially, is something I called out earlier on in the year, and I think most people picked up on that. The shape of the impairment for that business is going to follow the seasonal spending patterns, so there is a build-up in balances in the latter part of the year and flat to paying down of balances in the early part of the year. So Q3 impairment was certainly expected to be higher than Q2, and I think Q4 you would expect it to be a touch higher again as we go into Thanksgiving and the Christmas period, which tends to be the most active period.

When you step away from the dynamics of how the accounting charge works, we’re not really seeing any flashing lights or anything that gives us too much concern in US consumer credit from more leading indicators, be they delinquencies, be they affordability, be they spending patterns, spending behaviour even. So I think it looks okay at the moment, but we are cognisant that we are growing that business in what appears to be a record-length expansion and in the last year of a presidential cycle, which may or not be a good year. The first years following presidential cycles do tend to have an adjustment period, usually. And so, when you’re looking at the consumer credit business, we’re almost as much interested in what 2021 looks like than 2020 in of itself.

As a consequence of that, we are much more focused in growing our affinity business and partnership products, particularly in the airline space, which tends to have relatively high FICO scores and relatively low risks - so lower margin, lower risk products. We have not been growing the high risk parts of our portfolio much, particularly our own branded book; the Barclaycard branded business in the US, if anything, shrank slightly. So I know the accounting can be a little bit odd, but looking through it, I think that’s how we’re thinking about the businesses.

Ed Firth, KBW

I wasn’t thinking so much of the accounting; I was thinking if you look at [your US cards] arrears rates, they’ve gone from 2.4% to 2.6% [this quarter], which I know in itself is not a big number, but that’s sort of odd when, as you say, you’re growing the lower-risk part of the business rather than the higher-risk part, and it’s at a time when the balances have grown quite strongly. I would have thought [that the arrears rates] would be coming down, [so can you comment on that?]

Tushar Morzaria, Group Finance Director

I think it’s small differences on small numbers, so I don’t read too much into them. And as you said, we’ve been growing the portfolio reasonably steadily at mid-single-digit percentage, and you’re going to have a seasoning effect as those cards season and the actual revolving begins. We’re all looking for that canary in the coalmine, trust me, we’re looking as hard as anyone, but I’m not sure we’re seeing it yet. I would absolutely caution everybody that these are short-term indicators, and what feels relatively well-
controlled and where we would expect it to be now. It could feel different three or six months later, so we are very vigilant around that space.

**Jes Staley, Group Chief Executive Officer**

And as Tushar said, I think over the medium- and long-term, our focus will increasingly be on the co-brand space, and less so on the branded space.

**Robin Down, HSBC**

Just looking ahead slightly to 2020, I know obviously you’re keeping with the 10% plus [RoTE] target, consensus is at 8.4% for 2020, so quite a big gap there. I guess a couple of things that I would just highlight and want to get your views on. You seem to be suggesting a slightly lower run rate now for UK card losses going forward, but if you look at the overall group impairment charge in consensus for next year, it’s 20% up on this year. Do you feel that’s a realistic outcome, barring any major UK economic disaster?

Then, the second question, I guess what you’re really flagging up in terms of the challenging environment is what we’re all expecting, which is that the revenue environment is going to be that much weaker going forward. Can I ask you about the corollary of that? Do you see any cost flexibility in 2020? How much flex do you have there if revenues turn out to be weaker than expected?

**Tushar Morzaria, Group Finance Director**

On impairment, I won’t comment on next year’s consensus. It’s quite an uncertain environment we’re going into, but as I said in my scripted comments, we’ve guided to around £200m a quarter for BUK. I think that will be probably slightly at the upper end of performance from here, because our interest-earning balances in cards have reduced somewhat, and I see that trend continuing. So I don’t think [BUK impairment] be much lower, but they will be a bit lower than the £200m. And we’ve always talked in the past on CIB that it is much more of a name-specific type impairment story there. Again, hard to predict, because when it’s in single names, it’s always a little bit hard to tell, but somewhere around £50m a quarter is a good sort of benchmark to have out there.

And then for US cards, it’s a slightly different shape where it’s probably not as even over the year. It starts off lower and ends up higher, but if you take the average of where we’ve been running once you see Q4, it’s probably a reasonably good jumping-off point into next year. Of course, added to that, unlike in the UK cards business, we do expect the US cards book to grow, so you should layer on some growth as well when you’re doing your forecast. All of that is subject to all things being equal. Any changes in unemployment, revisions down in GDP, etc., IFRS 9 is sensitive to that, and so it will capture those effects pretty quickly.

**Jes Staley, Group Chief Executive Officer**

On the cost side, the first thing I’d say is I think we’ve done a pretty good job over the last three to four years of managing our costs down. We’ve pretty much delivered every year where we’ve guided to in terms of bringing our costs down. That being said, like in this quarter, we outperformed the consensus by quite a bit, almost driven entirely by the revenue line. So as we think about headwinds as a team, what we’d obviously like to do is to deal with those headwinds by delivering higher revenues than focusing on costs. I do think there are a lot of investment opportunities for the bank that we are making and that we need to make.
We've spent a lot of money in the last year bringing in new algorithms for all of our electronic trading, whether it’s cash equities or interest rate swaps. We do have the highest-rated mobile banking app in the UK, and we put a lot of investment in that. Part of the improvement in our corporate bank is driven by our transactional volumes coming out of Europe, which is all based on new operating technology for our Corporate Bank in Europe.

So what we’d like to do is to continue to invest, particularly around technology, in order to grow our revenues and not try to achieve these profitability targets by hitting on costs too hard. Like we’ve done in the last couple of quarters, we want to grow our revenues in the face of the interest rate environment that we’re dealing with, and take cost efficiencies and use them to invest in the business.

Martin Leitgeb, Goldman Sachs

Firstly, I would like to ask what your view is on capital return? I was just wondering, in terms of the new threshold, is your intention essentially to return capital as and when your CET1 ratio is above that new 13.5% threshold? And do you think the supervisor would grant you the permission for that? And related to that, what is your view at the present time when you’re considering dividends versus buy-backs? I note you obviously increased the dividend and the dividend outlook for this year. How do you gauge between the two, given where the stock is trading?

And the second question, more broadly on the Equities business in Europe and about the industry as a whole. Just looking at recent newsflow, we had one competitor pulling out of Equities last quarter, and there were reports out there that another major competitor is considering re-assessing its Equities franchise, and I was just wondering, how do you see the Equities industry evolving from here? What do you think the right positioning here is for Barclays going forward?

Jes Staley, Group Chief Executive Officer

First, on returning excess capital to shareholders, obviously the negative note for the third quarter is as well as returning excess capital to shareholders, we had to return excess capital to PPI claimants to the tune of £1.4 billion. We think our CET1 ratio, at around 13.5%, is appropriate, and over that level, as we generate capital, we think we can increase the return of capital to our shareholders.

We have tripled the dividend in the last two years to roughly 9p this year. Our payout ratio is around 40% and we’d probably like to keep that, but for sure, with the stock trading at where it is, buybacks are something that you would like to see, but we’re not going to talk about them until they start to happen.

In terms of the Equity franchise for the IB, I think to be a bulge-bracket investment bank in the two deepest capital markets, being Europe and the US, you have to be across all asset classes, which includes Equities. As we said, we’ve been investing in the electronic trading platform. We like the franchise that we’ve got. We think we’ve got very good research products, and we believe that we can compete with the major US players as we are, so we’re going to stay fully invested in that business.

Guy Stebbings, BNP Paribas

Firstly on costs, the sub £13.6bn target for the full-year you’ve reiterated, it’s looking quite tough. I appreciate currency was a headwind in Q3 and is currently expected to be a tailwind in Q4, as you say, but even adjusting for this appears to require a step down in the run rate of costs beyond what we’ve
seen so far this year. So I’m trying to understand where that could come from, because it seems like you’re guiding up on Head Office versus expectations, but presumably not enough for the delta in Barclays UK. So is it really the CIB we should be expecting this to come from? And with that in mind, if Q4 was quite strong in the CIB and you found it hard to justify a cost take-out there, would you be content missing the £13.6bn target?

And then, on capital, coming back to other forms of potential capital return, you’re now 10 basis points below the new target [of c.13.5%], and Q4 doesn’t tend to be a strong quarter for capital generation. RWAs have been growing, although that’s partly FX-related, and you’re accruing a larger ordinary [dividend] now than was the case previously. Should we therefore assume any discussions on excess capital repatriation beyond the ordinary dividend is really a topic for the first half of 2020 at the earliest? Or is there something else going on that I’m perhaps missing?

Tushar Morzaria, Group Finance Director

On costs, yes, all things being equal, you’ve done the maths and you’re absolutely right, you’d expect a step-down. Having said that, on bank levy, we were probably a little bit lower than the run-rate would imply last year. We had some benefits that were from prior tax periods that we were able to recognise in the fourth quarter of last year. So the bank levy actually may be up year on year, but that’s really just a function of some catch-up components that were just one-time in Q4 of last year. So bank levy will probably be in the range of £300m, maybe a bit higher. Anything else would be an implied step-down in the runrate.

On operational expenses, all things being equal, obviously there’s an FX component there that none of us know what it will be for the rest of the year. Through most of the divisions, I certainly see BUK being a touch lower as well as the CIB being a touch lower. I won’t comment so much on CC&P, because obviously that’s a growing business for us. It’s a high cost problem, but if we have a very strong performance in CIB, how would we think about incentive compensation in that business? We are a pay for performance culture, we look at everything in the round, we look at the overall Group’s profitability, we look at the divisional profitability, and we look at where we are competitively. We’ll just do the right thing.

I go back to what I said at the beginning, while the 9% [and 10% RoTE] targets are important to us, they’re more way markers rather than you absolutely need to hit specific levels. What’s more important to us is continued sequential profit improvement. So we’ll do the right thing in terms of managing the company for the medium term, rather than just making short-term decisions for the sake of it.

On your second question around capital and whether we should be entertaining any other forms of distribution in the first half [of 2020], I think Jes answered that in the earlier question. We’ll keep you updated as we go along, but I don’t think there’s anything we’re intending on guiding or commenting on at the moment. It’s something we’ll keep you posted on as the year progresses.

Guy Stebbings, BNP Paribas

Can I come back to your comments there on costs and the 9% return? Could you foresee a scenario where CIB revenues are stronger in Q4 and you therefore felt you had to pay for that, so you didn’t want to take the cost base down too much in CIB in the fourth quarter but you still missed the 9% return? Is that a scenario that you could envisage playing out still?
Jes Staley, Group Chief Executive Officer

I don't want to be too specific. You can look at the CIB cost numbers in the third quarter, where we had a pretty good performance, but at the same time the RoTE for the Group was 10.2%. So we're not going to slavishly be held to 9%, but obviously we all recognise that we need to deliver a good return to our shareholders, and that compensation is a variable that you can manage to deliver that return.

Fahed Kunwar, Redburn

On the balance sheet deployment to the investment bank, [...] if you look at the leverage, there is a leverage increase of around £21bn at the Group level, which I assume is the prime balances that you talked about. If I look at the share of the CIB, the percentage of Group capital has gone from 55% to 59% in the quarter. Where is that capped at at the moment? Do you think you will need to carry on deploying costs and capital to that business to carry on taking market share? Or do you think realistically, in the current environment with the cycle pick-up, you can take share while not deploying capital and cost to that business?

The second question is on the structural hedge, can you give us a sense of how much of a drag there is year on year as we're assessing your UK [Interest Rate Risk] (IRR) targets? You must know the answer to where the starting point is? If the yield curve inverts, do you just stop at reinvesting the hedge or do you carry on reinvesting it? Does it go negative?

Tushar Morzaria, Group Finance Director

With the percentage of risk weighted assets in the Group [RWAs] going up from 55% to 59% [in the CIB], you've got to remember that's nearly all driven by the fact that the operational risk weighted assets in Pillar 1 have reduced by £14bn and have been included in Pillar 2A. This is just a feature of the change in the treatment of risk weighted assets, which makes us more comparable to other banks, so we're comfortable with that.

The book growth that we saw in the CIB this quarter is just regular way stuff, and as I say, the average RWAs are actually [mostly] lower than the spot number, so I wouldn't characterise this as some sort of a net increase in capital to the CIB, and nor are we intending to do that.

Over the last probably two years, we've been operating at this level of risk weighted assets, plus or minus, , and you've seen we've been picking up market share in investment banking fees where we had our best third quarter ever. We were fifth in the US, ahead of one of the larger American peers, which we're very pleased with. In the Coalition data, I think you'll see that we're picking up Markets revenue share as well, so we will continue to do what we can there.

In terms of [structural] hedge drag, to try and help you out, if we take the yield curve as it was at the beginning of the year and look at where it is now, it's a bit lower now than it was earlier in the year. Earlier in the year. I threw out a number of about negative £50m in hedge contribution [at Q2 results]. That's probably nearer to negative £100m now at today's rates, but rates will go up and down and we have no idea which direction they're going in next. They've doubled since late September in terms of yield, so who knows where they'll go from here. We're not taking a view on rates as management. All we're doing is rolling our structural hedge to provide some stability to our income profile, so we'll continue to roll that rather than trying to get too clever and find a market as part of our structural hedging activity.

Fahed Kunwar, Redburn
Just one quick follow-up on the CIB, the percentage of Group risk-weighted assets is going close to 60%, do you have a cap in mind as to how much the CIB should consume of Group capital?

Tushar Morzaria, Group Finance Director

We don't have these artificial caps, because things will ebb and flow. All I would say is I don't think you'll see a net capital addition to the CIB on a trend basis at all. We've got enough and we'll do what we need to do with what we have. I would expect, on a trend basis over time, for our consumer businesses to grow. Obviously they're relatively slow in moving, but you see we're growing our US cards business for example, and we're growing our mortgage business. So I would expect to see our consumer-oriented businesses growing quicker and CIB holding roughly where it is.

Chris Cant, Autonomous

On Head Office, just looking at the quarterly print, you've got the minus £55m revenue print for the quarter, and that includes the benefit of the Absa dividend and obviously reflects the absence of the RCIs now. If I take that Q3 level as a steer, allowing for a bit of improvement on the drag from legacy derivatives and the annual effect of the Absa dividend, it looks to me like that would point to something like £250m of revenue drag in 2020. Is that reasonable?

And then on costs in Head Office, you seem to be settling into a c.£50m quarterly cost run rate excluding the bank levy. Should we be assuming £200m per annum going forward as Head Office costs?

Tushar Morzaria, Group Finance Director

On the income side, your characterisation is right, if you back out the Absa dividend, that's sort of one-off. I don't have the numbers in front of me, but it's nearer to £100m I would have thought. If I go back in time here, you've got the hedge accounting effects going on in the Head Office and there are unwinding of those hedge accounting effects that we had from the sale of our non-core divestitures. So these are technical accounting effects, which ought to come down a little bit over time to just ebb away I guess.

I think what I'll do is rather than now, but perhaps at the full year results, I think I'll probably give some guidance on what the Head Office income profile looks like. But generally speaking, you should see a slight ebb away for those underlying hedge accounting relationships as they expire.

And on the cost side, the one variable item there is we've got the Italian mortgages in our portfolio, and there are servicing costs and various other things that flow through the cost line as a consequence of that. To the extent we're able to divest of them, you will see a commensurate reduction in costs. So absent that I think it's where it is. To the extent you see us exiting in Italian mortgages, that should allow you to see the costs drop out there further.

Chris Cant, Autonomous

I appreciate you said you'd give some clearer remarks at full year results, but were you indicating that it was a £45m benefit from the Absa dividend in the quarter? So the current run rate for revenues is minus £100m a quarter pre Absa dividend? Is that what you said there?

Tushar Morzaria, Group Finance Director

It's a bit lower than that. From memory, I think the Absa dividend is closer to £30-35m.
Firstly on the UK consumer [cards] loan losses, it's only £49m, I think that's the lowest quarter on record. If I look at your IFRS 9 disclosure. I think it's stage two loans, not past due, that's come down quite materially, so it looks like you've refined some of your models in the UK cards book. Can you elaborate a bit more on exactly what's happening there please? And then the second question is on the transaction bank, I'm interested in the outlook there and the sensitivity to US rates?

Tushar Morzaria, Group Finance Director

On UK cards, you may have picked it up from my scripted comments, it is a lower impairment charge than you would normally have on a regular basis. The reason for that is that we periodically recalibrate our models from time to time.

IFRS 9 was introduced in the earlier part of 2018. A year and a half in, we decided to re-calibrate those models to actual experience, and as a result of that there's some sort of catch-up if anything else. Our actual customer behaviour has been better than we forecasted, so there's that one time catch-up, and that just feeds into, estimates around exposures of default and probability of defaults, which get recalibrated in line with actual experience. That's the non-recurring component.

I did guide a little bit earlier on that if you look at BUK in total, I've said £200m is a reasonable quarterly run rate. I think that's probably at the higher end of what I would expect. It won't be much lower, but probably a touch lower than the £200m.

Jes Staley, Group Chief Executive Office

On the transaction bank, it's got very little correlation I think with interest rates. What you're seeing in transaction banking for us is the impact of two initiatives. Firstly is the new platform we have for transaction banking for corporations in Continental Europe, which we rolled out a little over a year ago. We've already seen quite an up-tick in balances and deposits being left with us, and foreign exchange trade coming out of our clearing business there, so expanding our corporate platform from the UK to Europe has started to pay dividends.

And then secondly, and equally importantly, as we talked about last year, we've gone client by client, particularly with our largest clients, where we have a [low] return on risk weighted assets because of the extension of credit, principally non-drawn revolvers. Where we have a low return on risk weighted assets, we've gone to those customers and said either we have to increase our transactional volume through Treasury or we may step away from the facilities. We are about halfway through a two year process to do that. We've had a significant up-tick in our return on risk weighted assets for each of those clients, and that has been translated through the transaction volume line.

Tushar Morzaria, Group Finance Director

To add to Jes' point on that, we're able to offer transaction banking services in Continental Europe, now in five or six countries and we're going to see more coming online this year. We've added about 200 new clients over the course of this year, who are leaving cash with us as a result of those rollouts. So it's early days, but the client acquisition rates have been very good.
The other thing that is quite exciting for us in that business is joining that up with some of our payments capability. So another thing that we have rolling out is our merchant acquiring capability over about five or six countries in Europe, with several more countries like Poland and Austria coming online. The referrals between the corporate bank and the merchant acquiring business [have been very strong]. We've had a 19% increase in referral rates across that business. I wouldn't say this is going to make a huge difference to next year's numbers or perhaps even the year after, but when I look at the medium-term, the ability for us to attract these clients with no physical footprint in Europe and the cross-referral activity going on is a really nice trend. The business is extraordinarily capital light, not heavily regulated, and very additive to us.

Anke Reinken, RBC Capital Markets

Firstly, a follow-up on the NIM and going into 2020. From the comments you made about the structural drivers, is it fair to assume that we could assume a further decline into 2020 from the Q4 level? Secondly, on PPI, how comfortable are you with the £1.4bn provision? How far have you gone through the claims?

Tushar Morzaria, Group Finance Director

On your first question, I think Q4 NIM will be lower than Q3 NIM. It's a little bit hard to tell when you're projecting too far out, but there are two forces in play for us, or perhaps even three forces in play. One is growing our mortgage business quicker than our cards business, so that's dilutive to NIM just as a mathematical construct. Secondly, I do think our interest earning lending balances in cards are reducing and will continue to reduce a bit more, which obviously lowers our NIM. Then the third thing is the rates environment. Obviously we appear to have a lower rate environment entering 2020 than when we entered 2019. So those are factors that will probably put downward pressure on NIM into next year, but I wouldn’t extrapolate too far into the future. Obviously where mortgage margins and various other things go is very difficult to forecast.

On PPI, we feel good with our provision of £1.4bn. We've given some sensitivities in our release, which you can have a look at. It gives you a sense of the assumptions that we're making, and where those assumptions in real life will be different to our forecast. You will get a sense of what the range of outcomes are, but as we sit here today, everything that we've seen suggests that we're doing okay.

In terms of progress through PPI, we had, just like every other bank, an enormous inflow of claims. We're probably about two-thirds of the way through that big deluge, but there's a lot more to do. If you look at the claims that came in the July and August period, and I wouldn't say claims, but literally every piece of information that came in, we're about two-thirds through the initial process of sifting through those that are real and those that are not real.

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