Lee Street, Citigroup

On capital, obviously it’s quite hard to predict where the CET1 ratio is going to come out given what happened in the quarter. I know you were careful to avoid giving capital answers this morning, but is it fair to assume that you’re not going to need to redo the 13% threshold and drop below it. Is it fair to say that’s completely off the table now? That would be the first one.

The second one, just on Additional Tier 1 obviously your Pillar 2A requirement has come down and so I think your guidance is, you’re looking to run in, or about 100 basis points over and above what you need for the Pillar 2. Why are you keeping such a big hurdle, I guess, given the cost of that and what the rate environment is like?

And then finally, just to what extent, or how do you think about the big increase in Stage 2 wholesale loans that we’ve seen in the quarter? Is that just a consequence of IFRS 9, it’s not something to worry about? What colour would you give us to think about that, please?

Kathryn McLeland, Group Treasurer

So Lee, starting with capital, you referred back to the guidance we gave at Q1. Obviously at the Q1 results we’d seen a very meaningful impact from RWA inflation in Q1 when we were in the height of the stress in March, extreme moves in RWAs and increases, certainly, in market risk RWA in particular.

So we did certainly, at that time, not anticipate the quite extraordinary intervention that we saw in the second quarter from central banks and governments.

We had expected some of that RWA inflation to continue into the second quarter. Obviously what we saw, which you heard both on the equity call and just now is, obviously capital markets reopening significantly, more than half of our revolving credit facilities being repaid, consumer unsecured lending balances also reducing, and then we saw additional government support measures.

So where we stand today, we are 120 basis points above that 13%, and certainly, looking forward to the end of the year, what we’ve said in both these calls is that we do, cautiously, for planning purposes, assume some RWA inflation in the second half of the year. So that may put some downward pressure on the capital ratio, but it is quite difficult to tell exactly when that is going to happen, given the government support schemes that are in place and uncertainty as to what will happen when they end later this year, or, in fact, do they get extended.
The second impact on capital that we’d mentioned in the fixed income slides is, obviously as some of the Stage 2 and Stage 1 impairments migrate into Stage 3, they don’t get that 100% transitional relief. So at that point, should that come through in the second half of the year, you would also see an impact on the capital ratio, but we’re not guiding or referencing that 13% at all today.

We’re at a 300 basis point buffer to MDA, which has also reduced. That buffer is double what it was at Q1. It was about 150 basis points at Q1. So I think we feel confident in the capital ratio that we’re printing today. There may be some headwinds but there remains meaningful uncertainty in terms of when those headwinds or if those headwinds may come through.

In terms of the AT1, we’ve not actually guided to 100 basis points buffer. What we’ve talked about in terms of the amount of AT1 that we are comfortable holding is in terms of a percentage, and we’re around 3.4% at the moment. We’ve said we’re comfortable staying at around this level, and it’s a little bit above to accommodate FX volatility that we face. Obviously we’ve seen some extreme moves, and RWA volatility, which again we’ve seen some meaningful moves over the course of the year. It gives us some benefits for both of those under a BAU and stress, and also it gives us some Tier 1 benefits.

So look, we’re happy staying at above 3%, and I certainly wouldn’t encourage you to think about any buffer, I don’t think we’ve mentioned that in the context of AT1.

Tushar Morzaria, Group Finance Director

So, Stage 2 impairment for wholesale, as you pointed out, we’ve increased the amount of loans that we categorise as Stage 2.

That’s somewhat as a consequence of the triggers that we would use to do that staging migration, movement in Q1, for example, oil prices and various other things would result in automatic movement in those loans, as our assessment of the probability of default has changed.

Once those wholesale loans go into Stage 2, obviously we need to take expected losses that we may incur on it, and those loss estimations are, in many cases, driven by our individual credit officers, particularly for the more riskier and more larger credits.

So we would look at what collateral we have, how close we are to covenant breaches, whether we have heavy hedges in place, where we are in the capital structure, whether we’ve got an operating company exposure or a holding company exposure, etc.

That’ll be very much a key driver of the credits that are more significant, and particularly for the vulnerable sectors that we’ve pulled out in the slides from this morning. So we feel, actually, reasonably well covered there, given that we’ve transferred a lot of loans over and had our credit officers look at the most important ones there. So we feel pretty comfortable with where we are at the moment on that.

Robert Smalley, UBS

A few questions. First I want to start on slide 17 where you have a box talking about a temporary increase of less than one year wholesale funding. Could you talk about that, the need for that, particularly given the increase that we saw in deposits, and a couple of comments around that?
Have we seen these deposits stay relatively sticky in the bank despite that revolvers are getting paid down? Also on the same page, LCR at 186%. Is part of that Covid, is part of that Brexit? Can you give us a little idea on your thinking there? And then my last question is more general.

When we’re looking at some of the government mitigation programmes you’re participating in, is there any information that you can use from that around corporate or consumer behaviour to try and predict loan losses or impairments when we start to see them as these programmes roll off?

Kathryn McLeland

Yes. It’s good that you identified the increase in our short-term funding, because certainly we’d had those two pie charts showing how our reliance on short-term funding has reduced over the years.

So essentially, what we were doing in the second quarter is taking advantage of the reopening of money markets to increase our CP and CD issuance, and obviously try and get as decent duration in that as possible. So obviously three months, six months, ideally as long as possible, but we did really feel, again, that it was prudent to try and just increase the liquidity that we have, even if it is short-term liquidity. So we do think that that short-term percentage will reduce over time, but it was the prudent thing that we wanted to do in the second quarter.

Certainly, it has been quite encouraging for us to see strong money market conditions, good pricing that we’re able to get, new counterparties come online to us. So it was more of a prudent increase rather than anything else changing structurally in the balance sheet.

The deposit increase also that you highlighted is really quite an extraordinary impact of the QE that we’ve seen, here in the UK, also in the US. Some evidence of that was in the US banks’ initial results, and I think when they publish their additional disclosures you’ll see further details about that.

Obviously we’ve seen almost a 20% increase in corporate deposits, and business banking which is over 20%. And even on the consumer side, I think was about a 7% increase. So we’ve done a lot of work looking at the quality of those deposits, how we think about them in terms of stickiness.

Obviously we do see that some of these deposits are relatively good quality given that they’ve also benefited LCR ratios. Also just one interesting development which would impact us probably a little bit differently from some of the other UK players is that, should we perhaps see, say, consumers draw down on their deposits, you may then see that come back to us via corporate deposits.

So we’re in a slightly different position again, the diversification we’ve got across the Group’s balance sheet, across the Group’s P&L. We also actually benefit from having deposits from different types of depositors. From consumer, from business banking, and from corporate.

So certainly, again in terms of planning we will assume that some of those deposits may reduce over the second half of the year, for example. The BBLS programme in the UK, where we’ve extended north of £7 billion to the smaller UK entities, some of that will have flowed into higher deposits.

So again, for conservative reasons, we will assume some outflows. But certainly we do think that we would probably benefit, unlike some other banks, by having more diversified sources of deposits, so it might come back in through the door in another area. A lot of work has been done on that.
We also do our own conservative internal stress test, and you rightly identified, obviously, the two issues that we think about in the second half of the year: a potential worsening of the Covid scenario, and what that might do to liquidity for the bank and the rest of the sector.

Secondly, an increase in tensions, or difficulties with the negotiations between the UK and the EU. So I do probably expect that our liquidity will stay strong into the second half of the year, and then obviously further out we need to make sure that we’ve got the prudent mix of liability growth and asset growth.

For now, until we see some of this uncertainty with Brexit and with the Covid shape of the recovery from here, we will stay liquid. So I wouldn’t encourage you to think that the LCR will move materially.

Tushar Morzaria

On the government programmes, I’ll talk more about the consumer ones. Obviously for the corporate ones, things like the CBILS programme in the UK or the international commercial paper facility, again, for example, in the UK. We’re either doing a proper credit underwrite or indeed acting as the agent that takes the companies into those programmes. So I’ll put them to one side and focus more on maybe the consumer and small business area.

In a programme such as government furlough schemes, the bounce back loans for very small businesses, what we try and do as best as we can now, where we have a full banking relationship with a consumer, we have all sorts of indicators and flags, so we’ll try and identify if someone’s in, for example, a vulnerable sector or their spending patterns have changed in a way that puts up a flag, etc.

And we will try and proactively contact them to try and get ahead if there are any brewing issues there. And in the background we’re actually materially increasing the staffing that we have in the department for financial assistance. It’s really there to help those consumers that may end up struggling to make payments, to figure out what’s the best programme to get them onto, just to help them work through that situation.

One interesting set of data that we do have is, those customers that have paid down balances and / or indeed taken payment holidays, and that is quite interesting. For those where we’ve seen balance declines, particularly on card balances, it’s been noticeable actually, both in the United States and in the UK.

There may have been a feeling that it would be the better credits that would be able to pay down their balances and those that are a weaker credit would keep their card balance running, and therefore your riskiness of your portfolio as your balances decline, increases.

It’s actually not at all what’s happened. We’ve seen our balance declines really as a vertical slice of credit. They’ve all behaved very consistently and really declined very much as spending levels have declined. So we’re not seeing any particular decile of credit act any differently to any other decile.

The other interesting thing is on payment holidays, where both in the United States and in the UK we’ve granted holidays and in the UK got the option to extend. In the US, we’ve seen folks, as they’ve come off payment holidays and we’ve had a slide out in our equity slides this morning.

As people roll off, two interesting things happen. One is that about half of the consumers that elected to actually take a payment holiday did continue, indeed, to still make a payment even though they had a payment holiday. And secondly, those that have rolled off, I think already 80% are back on regular payment plans.
In the UK, similar situation, where again for those that are rolling off their payment holidays, 80% have already gone onto a regular payment plan. What we’ve seen in the UK thus far now, it’s a little bit early, because a lot of the first wave of payment holidays expire in July, so it’s a spot indicator, but we’re not seeing a very significant number of people, particularly in the unsecured credit balances, elect to extend their payment holidays where they have the right to do so.

That may change as we go into the summer. It’s a bit hard to forecast, but certainly, as we sit here at the moment it looks like those folks are behaving, if you like, rationally, and not looking to extend and roll further interest onto their balance. They’re looking to manage down their balance, given the high interest rates that you have on unsecured credit.

So hopefully that gives you a flavour of some of the stuff we’re seeing. The final thing I’d say, Rob, and really for others on the call, is it’s important for us when we take a step back from all of this is just what coverage ratios do we have against these types of credit. Now, for those that are on payment holidays, we’re, in the UK, over 40% provided for Stage 2 balances and most of the folks on payment holidays are in Stage 2. I think that is 35% or so in the US and a declining balance anyway.

When I look at unsecured credit, generally speaking in the UK business, UK cards were 16% coverage ratio, and almost 14% in the US. Just to give a measure of what does that mean, in our UK cards business, at the last recession, the global financial crisis of 2008 and 2009, our losses in UK cards were about 6.9%. Unemployment was about 8% to 9%, no government assistance programmes, a different recession and different characteristics. But obviously we’re extremely well covered relative to the losses we experienced then. So I hope that gives you a little bit of a flavour of what’s going on in the consumer books.

Tom Jenkins, Jefferies

Can you give us some guidance on your issuance supply expectations for, in particular, subordinated debt, really? AT1, Tier 2 for either the rest of the year or for next, as well, would be quite interesting to see what you’ve got planned. I’ve got a follow-up question after that, if that’s all right, but stick with that, very simply.

Kathryn McLeland

I made a couple of comments in the speech about that. So I guess you’ve seen that we’ve issued around £5 billion of MREL year to date. And we’d previously guided to about £7-8 billion for the year.

So today we’re reiterating the same issuance target for the year, so still around £7-8 billion. And at Q1 if you remember, we said we’d probably look to be doing around half of that in senior, but issuing across Tier 2 and also AT1 as well.

That really hasn’t changed, and so in thinking about the numbers for the year, we obviously need to think about what we might need between now and the end state requirement. As you know, we’ve been pretty successful at front-loading our issuance over the last couple of years, so we were doing several years of around £11-12 billion, which puts us in quite a nice position today where we’ve done a meaningful amount of what we had to do for the remainder of the year, and much less of the issuance we’ve been raising over the last couple of years. So we’ve said that we’ll look across the capital stack in terms of what we might issue in the remainder of the year.
The only thing you may have missed was, there was a question on AT1. And we’ve said that we’re happy with the current level we’ve got, which is around 3.4%, so in the low threes. But also you’ll be aware that we have Tier 2 redemptions in the future, so we might look also to raise Tier 2.

Tom Jenkins, Jefferies

I’ve got a follow-up, if you don’t mind and this is more personal curiosity. Others on this call may disagree but I looked at your numbers today and we were obviously looking at it from a bondholders’ perspective.

There were obviously certain parts you don’t want to see but there are more good things than bad things. I’m just wondering, I’m seeing the stock down, what is it, about 5.5% right now. Is it is just a bear rating by one particular house that might or might not be happening, or what are the internal thoughts on that? Because it does affect the appetite for the secondary or tertiary investor in Barclays’ paper. I just wondered if your internal thoughts, or whatever feedback you’ve got so far.

Is there a reason why there’s such a dichotomy between what seems to be pretty good results from a bondholder’s perspective, and what seems to be such not so good results from an equity holder’s perspective? A difficult question, but...

Tushar Morzaria

I’ve been doing this job long enough that I tend not to get too excited about the share price on the day. There have been quarters, and Kathryn’s done many of these with me as well, where I’m sometimes a bit surprised at how positive the reaction is and often a little bit surprised how negative it is.

On result days at least, in my experience there’s a lot of fast money that positions itself going into a set of results, and that creates a little bit of momentum one way or the other, and that’s just the way these things are.

I know I’ll tend to get a better sense of how people feel about where we’re performing in maybe two weeks or three weeks, a month’s time. We’ll see where we are by the end of the week, but as of this morning we were the best performing UK bank. So there’s maybe a little bit of that going on. Who knows?

I think you’re right, though, to say that, if I look at it from a financial resilience perspective we’re profitable in the first quarter, we’re profitable in the second quarter, and therefore profitable in the half. The capital ratio has never been so high, and liquidity level has never been so strong.

We’ve taken a fair chunk of impairment build, most of our charges in the first half have been impairment builds. Our coverage ratios are at pretty strong, robust levels. So we really feel we’re trying to have as strong and a protected balance sheet as we can, to be honest, and get to a point where we get clean earnings and sustainable levels of profit.

So I think that’ll pay out in due course, but on the day’s share price action I’ve given up trying to explain that. Take a 50-day moving average is probably more what I look at rather than on the day.

Tom Jenkins, Jefferies
That’s fair enough. It’s just, it comes across every now and again and you just think, what the hell? I normally throw those questions in the bin but I thought I’d ask it. What the hell? But thanks very much for your answers. I appreciate it.

Daniel David, Autonomous

I’ve got a couple of questions. The first one just on Libor transition, which is fast approaching. Could you just provide an update, and is there any cost guidance to be recognised, or has been recognised to date? And are there any worries with specific products missing the deadline as we approach?

And the second one, just moving on to the AT1 call in December, does NatWest’s recent issuance and call change your view on the economics, cognisant of the capital hit that they took? Also, just considering the legacy Tier 1, which wasn’t called in March, do you view the AT1 holders differently to those legacy Tier 1 holders? What might drive the call of one versus the other?

Kathryn McLeland

On Libor, I made a couple of comments in the script about that. It certainly is one of the biggest projects that we have within the bank, and it involves many work-streams, as you can imagine or know. From derivatives in the IB, to the loan book, to work in Treasury, and you will have seen the consent solicitation that we did for our sterling-covered bond, I think back at the end of Q1.

It’s obviously one of the areas that the regulator’s also been quite clear that there’s going to be no delay in terms of the compliance date. I think we have seen a push-out by about four months for sterling loans, which has recently been done, I think from September to January.

We certainly remain very much on track, and are engaged also in all the external industry working groups. Obviously you know Tushar’s role here in the UK. So I think you asked about cost. There are a couple of questions on cost in the equity call this morning. There’s nothing really to call out on Libor.

As I said, it’s a project, we manage it like we do some of these other big reg projects we might have. That’s just all taken into account in terms of us trying to ensure that we are disciplined on cost and that we see positive draws and are careful as we think about the subdued economic backdrop.

So in terms of how we think about AT1 and the position with regards to the security that’s callable in December, and whether there’s any different approach between that and other legacy securities, I’ll just make one important comment and I’ll hand over to Miray.

Obviously, we’ve seen not just NatWest but Lloyds taking a different route on their AT1. So we have very much the same approach we’ve always had, which is, we consider economics in the round, and that captures everything from the day one FX impact, the refinancing spread, impact on the broader liability stack.

Sometimes we refinance in different currencies, which may make it a little bit different. I suppose, obviously just at the moment you’d expect us, as you’ve heard in a remark from Jes and Tushar this morning and today, to remain really careful and conservative in our planning assumptions.

You’d obviously expect us and other UK banks and the regulator to act in the same way, given the stress that we’re in.
Miray Muminoglu, Head of Term Funding

What I would add, with regards to the February non-call, the legacy securities, we believe we’ve done a good job explaining that at the time, engaging with a number of investors, obviously that was an exchange security. So we gave an out to investors many years ago, that they could go into an AT1. That AT1 was called on time last year and there was only a rump of 300-odd million outstanding.

So certainly, that is a different consideration compared to, perhaps, the new generation securities. It was also important that that was good Tier 1 for us for some more time to come with a very, very attractive cost of funds. So I wouldn’t necessarily compare them like for like. I would just reiterate that, for every security, because these things will happen case by case, we will run the same test of our economics in the round, and that will be the case going forward for AT1 as well.
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