Tushar Morzaria, Group Finance Director

Hi, everyone, and thanks for joining us this afternoon. […] I’m also joined this afternoon by Anna Cross, Deputy Group Finance Director. […]

I thought I’d make a few opening remarks, just to underscore some of the main points we wanted to make during the earnings call, and then we’ll open up for Q&A.

Please do send us your feedback on whether you find these calls helpful, format, timing or anything else you’d like to include. Do send them to Chris and [the Investor Relations] team and we’d welcome any feedback, good or bad. With that, just a few opening comments from me, before we dive into questions.

The diversified business model is a big thing for us, combining the consumer businesses and wholesale businesses to deliver a smoother earnings trajectory. That’s working out well thus far. We had a Q2 RoTE of 18.1%, with an EPS of 12.3p, and a pre-tax profit of £2.6bn. We didn’t say it so much on the call, because obviously we had a decent impairment release, but it is record profitability, beating our Q1 of £2.4bn, which was our previous record.

Given the strength of statutory earnings in the first half, it’s probably no surprise that we guided to expecting above 10% RoTE for the full year. More importantly, this is a target that we feel, now that we’ve hopefully crossed the 10% threshold after many years of work in progress, is a target that is the right target for us next year and the year after. This is something we’ll try and aim to achieve every year, beginning now and we’ll see how we do.

On the top line, just to remind you that income in the second quarter did increase 1% YoY. That was against a pretty material FX headwind. If you neutralised for currency rates, it was a 7% YoY increase, mostly reflecting improved income from the consumer businesses and some in Head Office, offset by the CIB, which obviously had a very tough comparative in Q2 last year.

In CIB, the bright spots very much were in Equities and in Investment Banking fees. Both were at record levels. For fees, it was the best ever quarter, and in Equities, it was the second best ever quarter after Q1. Good performance across the waterfronts there, in cash equities, derivatives and financing, and in Investment Banking fees, in Equity Capital Markets and Advisory. So, really pleased with the performance there.

In the UK bank, mortgages continue to be the bright spot. Again, I don’t think we called this out [on the results call] but I think we ran at record levels of net production in the first quarter and our nominal mortgages have hit an all-time high on our balance sheet.

Margins have been pretty decent in the first half, better than we expected, but we are expecting margins to reduce from here as, supply and demand becomes more in balance. So I wouldn’t be surprised if we sustained the very robust margins we’ve had in the first half.

On the “not so good” side, gross UK card balances were down £300m. Hopefully, we will see balances increase in the second half as spending transmits itself more into credit card spend. Even though spend levels are pretty healthy, they’re probably more geared towards debit cards at the moment.
I think that even though you might see some balance increase, it’s going to take some time to actually transmit into interest-earning balances - I think that’s and that’s probably more of a next year story.

We guided to UK NIM to be at the top end of the 240-250 bps range [for the full year]. A few things are going on there. We don’t expect a repeat of the first half’s mortgage performance, both as a margin matter, but probably also as a volume matter as well. So, that’s going to have less fuel in the second half, and of course we’re not expecting interest-earning card balances to improve. So, the grinding forward of the mix effect and you’ve still got some grinding effect from shortfall hedges - that is all working its way through.

The other thing that I think other banks have called out which has some relevance to us, there were some early redemptions on mortgages in the second quarter as well. That can be episodic and seasonal, and some around the stamp duty holiday as well. It is probably not repeatable and that certainly helped margin in the first half. So, just to remind people on that.

In our final segment, in Consumer, Cards and Payments, CC&P, a decent increase there, somewhat driven by Unified Payments, where income was up 17% [on Q1], obviously from a lockdown quarter to a non-lockdown quarter but we also had a gain on a property sale in the Private Bank, so that helped.

US Cards balances, good news and bad news: on the good news, they did end the quarter higher but the average balance was lower. So, I suppose we exited the quarter better than the quarter generally. Most of that increase in balances, though, was transactor balances, full payer balances, if you like.

While I’m hopeful that organic card balances, away from any portfolio additions like the American Retirees partnership that we have, will hopefully tick up, I don’t think it will happen until late in the back end of the year. So, probably, again, more of a 2022 story, I think, than something that will see a meaningful impact this year.

On the costs, you’ll be familiar with the cost number, 10% up at £3.7bn, mostly driven by the increased structural cost actions, by the property exit that was almost £300m. We are guiding for full year base costs, which is excluding performance costs and excluding the episodic structural cost actions, to be about £12bn. It depends on currency rates and partially volume-related activity, as well, but it should be somewhere around £12bn.

Q2 performance costs were broadly flat YoY and the first half, the bulk of the increase, in fact all of the increase, was really put through in Q1. I think that is probably just a more seasonal shape that we look like we may have this year, where most of the comp [year-on-year] difference will be accrued in the first half of the year. We’ll see how we do for the second half but I think that’s probably more likely to be the shape, more front-loading of comp.

I think that’s all we wanted to say on cost. The only other message was that £12bn of base costs is probably an okay planning assumption for now into 2022. We’ll obviously see how the recovery goes and the balance of investment spend and efficiency programmes, but we think £12bn is about right for now.

Impairment, a fairly significant release of about £1.0bn, against an ongoing run rate charge of about £200m, leading to net impairment benefit of £800m. A few things there: I think the most important thing is probably the run rate level.

It feels, given the size of the balance sheet and the quality of the books at the moment, that run rate impairments will be below the historical levels. I think most of you have probably modelled somewhere around £500m or so a quarter in the past, pre-pandemic, when I look at old consensus tables.

I think we’ll be a bit under that but probably not as low at the £200m or so we may have had in the second quarter, simply because we do expect the recovery to pick up and with IFRS 9 it’s a forward-looking balance, so you will start building impairment as assets come on, but still overall I think much, much lower than we’ve had in the past.

We’re still carrying a decent sized management adjustment or management overlay. The number I call out there is the £2.1bn that really is there for our view that there is [considerable] economic uncertainty. That means that as the government schemes are withdrawn, we will digest that reserve against credit performance. If that [provision] is not required, obviously there’s potential for more P&L that may make its way there and, indeed, more capital possibly.
But, our view is that we’ll probably need that management adjustment. We’ll probably know the answer to this over the next handful of quarters. The government schemes are beginning to be withdrawn now. So I think as the next several quarters, two, three, four quarters go on, we’ll have a better sense of where we come out.

On capital, we’re still targeting a 13-14% range and our half year number was significantly above that, at 15.1%. There are some mechanical headwinds that we called out. You’ve obviously got the share buyback that we announced. We’ve got a Q3 scheduled pension contribution. The buyback is worth 17 bps. The pension contribution is worth 11 bps [pre-tax].

We should see stage three balances pick up a bit, and I talked about the impairment run rate. That will feed in [against] capital, as well.

We had quite a low RWA print, and that sometimes happens, mostly in the investment bank. This is the way the banking deal calendars work out and activity levels work out. I wouldn’t take that as a new jumping off point. That’s probably a bit lower than we would have anticipated.

We’ve also got 2022 headwinds. You’ve got the software benefit reversal, and you’ve got a further grinding down of the amortisation of the IFRS 9 transitional release. The software reversal is about 40 bps in round numbers, IFRS 9 transitional relief about 15 bps, and then you’ve got regulatory changes, standardised approach to counterparty credit risk. That’s worth somewhere between 10 and 15 bps. Then, a further pension deficit reduction in 2022, another 10 bps.

So, there’s a few headwinds there. Having said all of that, I still think we should be comfortably above the top end of our stated [target] range of 13-14%. It is probably meaningfully above 14% and it should give us the capacity to make decent returns of capital to shareholders.

On that, we did announce a 2.0p interim. We’ve been quite open to say we’re accruing for a 6.0p full year dividend. I wouldn’t take that as gospel. The board will make a final decision on dividend levels obviously at the full year results, but that is what we’re accruing for now.

The buyback of £500m will begin, I believe, this week. That’s with our brokers to start executing, and you’ll see that through the RNSs that we put out and, of course, that’s in addition to the £700m buyback we completed during April of this year.

One of the things you’ll see on our performance highlights and on our tables, is that we are calling out share count more prominently, and I think that’s just to let you know that these buybacks are a genuine reduction in share count, and hopefully will improve not only tangible book value but EPS accretion, particularly at these share price levels.

I will pause there. That’s a lot of messages out there but I’m sure you’ve got plenty of other questions.

Raul Sinha, J.P. Morgan

I just have two areas that I wanted to come back to. The first one was going back to your slightly more cautious view on UK unsecured recovery. I think you flagged that on the call, that you were probably a bit more positive on the US side than the UK side. I was trying to understand, within that, what are the drivers you are assuming for the second half of the year.

One question around whether the market share of credit cards within overall unsecured including point-of-sale finance is reducing, and whether you’re seeing any disruption because of other companies, particularly in the Buy-Now Pay-Later space, which might be taking over some share from you. Are you seeing any signs of that? Is that partly driving some of your caution?

The other question I had was around structural costs. I was just trying to understand how to think about the right run rate for this beyond this year. When I look at the branch optimisation potential, 755 [branches] still looks like a very high number of branches in the UK given the amount of digital utilisation.
How should we think about the pacing of the branch optimisation costs from next year? Is there potential for that to pick up along with the UK transformation, or do you think this is something that is going to be quite episodic and quite difficult to have any predictability on?

**Tushar Morzaria, Group Finance Director**

I’ll make a few comments on unsecured and I’ll ask Anna to comment on that, as well. Anna, for those of you that may not know, used to be the UK bank’s CFO, so she’s well-versed in some of the customer dynamics and the drivers around UK unsecured lending. I’ll just make a couple of comments on that. Then, I’ll cover costs and then I’ll ask Anna to talk more about the unsecured UK market.

I think that other people have definitely sounded more optimistic than us, and in some ways it is great if they’re right and we’re too cautious, because obviously it will be beneficial to us.

I think that what we’re seeing though is the increase in spend in the UK has definitely been more debit card orientated, and we’re not seeing as yet credit card spend levels get to a level where you’d automatically expect to see balance formation in interest earning lending.

I think we will see balances pick up but not necessarily driving revolving balances. We need to see more on card spend and more on discretionary items, particularly travel. I will get Anna to talk more about the dynamics there and also on whether we’re ceding market share to Buy-Now Pay-Later and other forms of unsecured credit.

On the structural cost actions, it is really good question. It is striking what’s been going on here. When I joined the bank, I think we had something like 1,700 branches and we’re somewhere around 700-750 [branches] now and yet, like you say, I think there’s plenty more that is going to carry on. So, it’s quite extraordinary what’s been happening in the last handful of years.

In terms of modelling structural costs, I would say that the best guidance I could give you for 2022 would be probably not that dissimilar to 2021 but probably not with a repeat of the large real estate charge we took in Q2. We took about £260m as a result of the exit of 5 North Colonnade here, in Canary Wharf.

It’s unlikely we’re going to do anything as individually significant as that but I do think that if you go in the previous year and the year before that, where we’ve called out, we’ve done something like £300m in the past.

I think we will do some more actions, probably in the fourth quarter this year. Again, probably accelerating some of the work around our UK bank transformation. You mentioned real estate. I think there’s other things that we’d look to try and get going quicker, so that we can get those cost savings in as soon as possible.

As and when we do these, we’ll call out some of the benefits where they’re individually material, so example the exit of the property of 5 North Colonnade in 2023 onwards will give you a £50m benefit for every year from that point on. These are good actions.

[…] That hopefully, gives you an anchor to try and estimate what that may look like next year, so something like a historical number. This year it will be in that zip code, excluding the Canary Wharf exit, is probably a little bit unusual in terms of scale.

We will measure our performance on a statutory basis. You get a sense of what we’re trying to do with our cost base but when we talk about our overall returns, we’re trying to include all those costs in there, so maybe that gives you a sense of the profitability objectives that we’re setting for ourselves.

We think of these things as episodic and non-recurring. We don’t want to be sitting here in three years’ time, constantly putting through some sort of structural cost action every quarter. In my mind, it becomes run rate, but hopefully that gives you at least some anchor for modelling.

Anna, do you want talk more about the dynamics around unsecured credit market share and what we need to see to see balances tick up, etc?
Anna Cross, Deputy Group Finance Director

Tushar has called out the fact that we are seeing a gradual increase in consumer spending, particularly towards the back end of the quarter. As he said, though, that is biased to debit rather than credit. I’d also remind you that we see out there pretty high levels of current account and savings balances.

Those two things taken together suggest that we’re going to see more transacting behaviour in the shorter term. I’d expect that to be our lead indicator to subsequent IEL growth, but it will take a while for the transacting behaviour to transmit through to IELs.

I think the other factor to consider is that the zero balance transfer market is alive and well and very open, so I would expect to see a pick-up in balances there. Again, that will probably hold interest earning lending back a little in the short-term, because we’d expect to see customers get their new zero balance before they start purchasing and building an IEL balance. But, also, it will take a while for those balances to mature through those promotion period.

Even if you spent some money today [and don’t pay down], it takes broadly 60 days to flow through to IEL. So, even in the ordinary course of business, it’s not immediate transmission, but I think those other factors of preponderance to debit card, the large savings balances, and also the reopening of the zero balance transfer market are probably relevant.

I think the other thing to consider is that the pandemic has coincided with quite a significant regulation shift in credit cards in the face of persistent debt regulation. So, what will have been happening in the background is that you would have seen a gradual moving down of interest earning lending balances anyway, I think, so you should probably factor that in too.

As concerns other forms of unsecured lending, to your specific question, I would say that the economic factors I’ve called out are bigger in scale than any significant move to other forms of unsecured lending and we would see it more as an opportunity for us to participate fully across that spectrum of unsecured lending that goes from cards all the way through to overdrafts.

I think we’ve spoken before about the new consumer products and we would see increased regulation in that space as being more of a tailwind for us. So, I think it’s an opportunity rather than something we see specifically right now as dragging those cards balances down.

Raul Sinha, J.P.Morgan

Anna, can I just follow-up on the persistent debt regulatory impact? Do you think that’s totally washed through in terms of its impact for the industry, or is there still some lagged impact ahead of us as you help these customers?

Anna Cross, Deputy Group Finance Director

There’s perhaps still some lagged impact. It is probably more of a detailed matter we can discuss further, but I would say the majority of it will have washed through by now but maybe a little bit more to go. If you recall the regulations, there are two time periods. There is the 18 [month] and then the 36-month time period, so I think we’re coming up on that one now.

Tushar Morzaria, Group Finance Director

I think balances that are beyond 18 [months] are really small. I think Anna is right. Most of it is small. I would say, just final comment to Anna’s point, while we’re cautious for this year, this isn’t the death of the credit card or anything like that, we feel pretty good about it going into next year, more so in the US probably. But, I think it is just a timing factor rather than whether this business is ever going to come back. It will come back and it will come back pretty well, I think. It will just be more into next year.
Alvaro Serrano, Morgan Stanley

I had a question on capital and another on the market environment, revenue environment. On capital, you appear not to have detailed the impact of Basel IV. I don’t know if you can give any colour.

Obviously, any numbers would be useful but the question is also focused on contextualising the shareholder distribution expectations. If I look at consensus between share buybacks and dividends, if I look at 2022, there’s more than 50% payout and if you’re going to have to make some room to absorb potentially any Basel IV impacts early 2023, is this something we should take into account?

I know you’ve detailed 2022 headwinds but maybe a word on this and, in particular because my recollection has always been the regulator is going to compensate part, or all, of the impact, but your peers are definitely not calling this out. Any thoughts on that?

And second on Markets, you’ve done very well again, relative [to peers]. I know it’s difficult to give guidance but [what is] the state of play? Obviously FICC was very strong last year. I don’t know how far down the line of normalisation we are, is Q2 more normalised in FICC, and similarly in Equities, […] is this business as usual? We obviously had a very strong pipeline in ECM, any colour on what to expect going forward?

Tushar Morzaria, Group Finance Director

On capital and particularly Basel IV, I know many banks have given guidance and particularly a lot of the European banks. I still don’t think I know enough about what is going to be applied to UK banks as a rule book matter to give any firm guidance.

When I’ve given early guidance [previously] I wonder why I bothered. I always give the example that I guided on the Fundamental Review of the Trading Book, it must have been five years ago now or something like that. We haven’t even disclosed the number yet. It is hardly worth doing anything these days anyway because they give enough time for banks to adapt their business models to changes in the prudential rule book, and they can adapt their businesses accordingly.

It’s not something that is on my big worry list, if you like. It’s not something that I worry about, that I’ve got to keep a lot of capital capacity to deal with it. Part of it is because the UK framework has used Pillar 2A in principle to pre-fund some of this stuff. It’s true for most of the UK banks. There should be a partial offset if the regulators are true to their word. I also think the timing of it for UK banks is not entirely certain, as yet.

But, having said that, if we get some firm rules and this is when they’re going to come in, then obviously we’ll guide accordingly, and let you know what sort of impact it makes to us.

The other comment I’d make is distributions back to shareholders is important to us. We’ll probably stay above our top end of the range until we’re through the pandemic period and when we’ve got a post-pandemic economy that has settled down. That’s probably the next time we would want to rethink whether we want to go within our stated range or not.

By that time, who knows exactly when that will be but maybe we’ll get clarity on some Basel IV timing or the types of things that the UK regulator chooses to do, and how they think about that from the various other things like Pillar 2A that they’ve already applied.

So, maybe that will go into the mix then, but I would have thought we’d stay above our stated range for quite a bit of time yet, certainly until we’re settled down in the post-pandemic economy.

On investment banking, the market is always really tough to give precise guidance on. The only thing I’d say there is, there will be good quarters and not so good quarters. That’s just life in this business and you guys are all extremely familiar with that, being in the business yourselves.
Rather than getting too precise around this quarter will be that and the next quarter will be that, I think on more of a trend basis, my sense is that the activity levels are likely to be higher than they were pre-pandemic. There will be quiet periods, there will be busy period, but on an average basis I think they will be higher.

I think activity is likely to be more concentrated because of the capital that has left the industry, so there’s just fewer participants. If you’re on periphery of these businesses, you’re probably won’t be getting much of the action. I think you have to be a solid incumbent.

There are two other factors I think are important. I think regulation, subject to your question on Basel IV but even notwithstanding that, I do think regulation feels more stable in wholesale banking. The last decade has seen monumental changes in investment banking and the prudential framework, as you guys would be familiar with. That doesn’t feel like it is going to repeat itself.

That stability, I think, helps us create capacity to manage the business. I also think that if you look at the number of financial instruments that have been created literally over the last few years in the short-term, the number of credit instruments has just mushroomed and now all of those need to be refinanced at some point, all of them will needed to be traded, all of them will need to be hedged.

That’s true of many financial instruments and that feeds a lot of primary market activity, as well, and this raising of finance is used for other activities. I think that being a participant when the pool of financial instruments and liquidity has just gone up, if feels like activity levels will just be structurally higher.

So, rather than maybe give guidance on the next quarter or the quarter after, I was going to say over the next three years, I would suggest that activity levels will be higher than maybe the three year preceding the pandemic and I think the level of that profitability will be concentrated in the remaining banks.

The other final comment I’d make on Markets or investment banking in general, you mentioned Investment Banking fees, as well, where the pipeline is pretty strong. We see that from Dealogic-type data. I do think that is still going to be a US-dominant business. You’ve got to be in the US to get the full share of profitability.

If you’re not a big incumbent in the US today, you’re never really going to get in, because the barriers to entry are so high, with the prudential rule book and ringfencing and intermediate holding company requirements. The ringfencing, effectively, of investment banking operations in the US has made it, I think, insurmountable if you’re not already there, and [there have been many] failed M&A deals.

So, I think for those structural reasons, I’m much more constructive on the outlook, but don’t take that as a Q3 comment, necessarily. I’m loathe to give near-term [guidance] but it gives you, at least, a trend basis.

Omar Keenan, Credit Suisse

I just wanted to ask a question about a comment that you made earlier on in the call. Hopefully, now that Barclays has crossed the 10% threshold, one would hope that would be achieved every year.

Just, perhaps, looking forward to 2022/2023, and if we think that from this year there will be some gradual normalisation in credit impairment charges that should be offset with revenue recovery, I just wanted to hear your thoughts on where you think the most important drivers of those revenues are, and whether you think Barclays is currently running far enough below normalised income, in businesses like CC&P and non-interest income in the UK, such that that can happen.

Tushar Morzaria, Group Finance Director

I’ll ask Anna to contribute some of comments on the top line, particularly on perhaps CC&P and even on the UK side. But, I think, in headline our objective is to have every division above 10%. In a good part of the cycle, in the earlier stages of the cycle where we’re geared towards a growing economy, all of those businesses should be above 10%, but there will be points where there will be the diversification benefits of having divisions. So, in a year like this, [the Group will still ] be above 10%, [while not all businesses are].
Now, it is only six months and we don’t want to carried away, and there’s bank levies and various other things that don’t get included in the first six months, but even if you strip out impairment releases and deferred tax gains and maybe ignore the property charges, all these non-recurring items as you might think of it, both in Q1 and Q2, the company has been running above 10% RoTE.

That’s the benefit of diversification coming though, the strength in IB offsetting the weakness in consumer. As we go forward, I think we will see the consumer businesses’ top line restock. I’ll ask Anna to talk a little bit about that.

I also think, based on the comments I made to Alvaro’s question, we have a degree of confidence that now we’ve crossed the 10% threshold for the CIB, we want to keep it there, and then you’ll judge us on our ability to deliver. But we’re probably more constructive on that environment than perhaps others are. They’re probably fearing a much more sharper contraction in revenues there than we expect to see, and, of course, one of the other things that has been important for us in the CIB has been cost control. We are seeing very strong operating leverage there and that hopefully puts us in good shape, as well.

Anna, do you want to touch on some of the recovery in [...] corporate and consumer credit, etc?

**Anna Cross, Deputy Group Finance Director**

Let me start with the US and then I’ll come back to the UK.

In the US, I guess we’ve got the recovery of the existing card stock, and we’re seeing US card spending in June at 2019 levels and we’re seeing airport footfall recovering. I would say also the partner spending is trending well. We’re seeing good levels of [customer] acquisitions, so the early signs are good in cards in the US.

I’d also say that we’re seeing still higher levels of repayment. So, it will take a while for those interest-earning balances or ending net receivables to grow significantly, but all the signs are there.

Then, of course, we’ve got the inorganic blocks that we’re adding in there, so whether that be AARP, the renewal of JetBlue or, indeed, Gap. They will significantly increase the balances in the US cards business to pre-pandemic levels I would expect by the back end of next year.

Coming to the UK, there’s clearly the mortgage outlook which looks strong still from a volume perspective. Clearly, we’re expecting margins and volumes to come down a little bit from their current peak, but pricing remains attractive and that’s a business that we like.

On cards, as I said before, we may see some muted demand in the short-term but, certainly, from a supply side, we are leaning into that risk. All of the pandemic-related risk reductions that we saw across the industry have been removed, pretty much, apart from in the highest risk areas there. So, we’re certainly ready for that growth.

The other thing that we’re looking at very holistically, as I’ve touched on before, is the whole continuum of unsecured lending, and particularly around Point-of-Sale and that sort of merchant-led lending that we are doing, both in the UK and in Germany, which is very important for growth.

The other area I’d call out, of course, is Payments and specifically our merchant-acquiring business. That will benefit from the easing of lockdown, so we see a positive trajectory for turnover and transactions there. The exact shape of how that is emerging is quite interesting. We’ve seen e-commerce spending pretty flat and face-to-face spending pick up. We haven’t seen them swap back round again, so that’s pretty interesting. We’ve also got some acquiring ambitions with SMEs and that’s great for us, because it helps us link the really strong SME franchise we have in the UK with that merchant-acquiring franchise, and the margins are slightly higher in SME than they are in larger corporates.

Then, finally, I would say not to forget wholesale. Over time we’d expect the type of lending that has been supportive through the pandemic will start to fall away, perhaps be replaced by greater demand for what you might call more normal margin corporate and business banking lending.

Also, those businesses are very geared to economic recovery themselves, so whether that be payments activity, FX activity etc. They are really strong franchises for us. So, lot’s going on in the real economy, I would say.
Omar Keenan, Credit Suisse

Just on the US cards inorganic opportunities like the Gap portfolio. I don’t know if you’d previously discussed what the J-curve on inorganic opportunities like that looks like. Is there perhaps any further colour on that? Would Barclays be looking at other similar opportunities and are there many of these opportunities around?

Anna Cross, Deputy Group Finance Director

What I would say is that opportunities do come up. We face intense competition for those opportunities but we do have a really disciplined approach to returns which I’ll describe. What that means is that we’re not afraid to walk away like we have done from partners in the past, but equally we feel like we’ve got the opportunity to win even when that competition is intense like, for example, with JetBlue more recently.

The way we think about it is that we would seek to achieve a return above the cost of capital over the lifetime of the client. Now, what that means is in the shorter-term I would expect a weaker RoTE, and that’s simply because you’ve got the acquisition and marketing costs of acquiring the customers in the first place. Then, there are the reward costs with the partner.

Some of those manifest themselves on the cost line. Some of them are contra revenue. So, I’d expect those to occur almost before balances start to appear in a meaningful way. I’d also remind you that under IFRS 9 we’re booking impairment from day one as well, so I’d expect weaker RoTEs in the early years, maturing to stronger ones in the outer years, and averaging out above the cost of capital. That’s kind of how I would think it through.

Chris Cant, Autonomous

Two quick modelling-type ones. Firstly, I think your sub-60% cost/income target is now inclusive of litigation and conduct, whereas I think historically when you set that it was excluding litigation and conduct. So, could you just give us a sense of what sort of run rate of litigation and conduct cost you expect to be carrying on an ongoing basis beyond 2021?

Then, secondly, you mentioned not to take the Q2 RWAs as a jumping off point. I appreciate that RWAs are one of those things where we’ve all got it wrong over the last year, and a bit in terms of procyclicality, but how should we be thinking about that into year end. I know we’ve got some stuff coming on 1 Jan 2022, and obviously we can do some numbers work with comments you’ve given us. But, should we be thinking pre that something like £315bn or are we flat on 2020, which I think is where you ended the half?

Tushar Morzaria, Group Finance Director

I think on conduct and litigation, famous last words, but obviously there were some monster charges in the past. I’m hoping these become, frankly, insignificant. Now, what does insignificant mean if we’re running base costs of around £12bn?

I’m loathe to put a number out there but at the moment I think we report it as a separate line item because we’ve still got the Q3 19 PPI charge that runs through there. I think when that drops out of our historical time series, that quarterly time series, we’re probably looking to not call it out, and just have it in the opex line.

I’m loathe to give you a number, because as soon as I say it I think we’ll get a whopping big fine on something that we did ten years ago, but our expectation is that it is insignificant and shouldn’t be a drag to hitting our efficiency targets, let alone our cost objectives, if that helps. I know I haven’t given you a direct number, Chris, but hopefully it gives you at least a sense of how we think about it.

The RWAs for full year, again, a little bit of a tricky one. I would say that full year RWA tends to be repeated seasonally low, and that’s because, generally speaking, IB activity between the Christmas period and New Year becomes very slow, so your trading book is kind of square as you go into the New Year, and deal activity, underwriting activity slows down.
So, we typically have a lowish print in the fourth quarter. We should have a similar sort of pattern this year and there is nothing I can see to suggest that it will be anything other than a normal year.

But Q2 was a little bit unusual. It sort of felt a bit like a year-end to us in the sense that it was actually a pretty decent quarter in capital markets. The calendar in which underwriting various deals happened was just a little bit light, literally as we crossed the quarter period, and that is a bit unusual. The actual financial market volatility was also a little bit low.

That’s why I wouldn’t use that as a jumping off point. If you look through Q2 and just look at, if you like, a more typical pattern over a year, that’s probably not a bad reference point. Your point on procyclicality is a good one. I guess you can never say no, but I’ve been saying that we would expect procyclicality for the last four quarters and I’ve been wrong every quarter. Now, that I’ve dropped it, it probably means we’ll get procyclicality. Hopefully, that’s behind us now, but we’ll see.

**Guy Stebbings, Exane BNP Paribas**

I had a couple of follow-ups, one on capital and then one on US partnerships.

On capital, I’m just interested in your comments about staying above the range while the pandemic remains. It makes sense to me that ahead of some of 1 Jan 2022 headwinds that would be the case, but uncertainty on COVID is fading. You’ve got the PMA there in any case. Countercyclical buffers are currently zero and reflected in the MDAs.

I guess the regulator would probably now be more comfortable with you operating within your range or the bottom of the range than it might be in a couple of years’ time when countercyclical buffers creep back up. I’m just interested if there is anything you can say on timing around when you might operate back in the range, and then, more broadly, should we just ignore things like the countercyclical buffer moving up, because it is really your own risk appetite that will dictate what capital you run with, unless regulatory requirements jump significantly.

The second question on US partnerships. I appreciate the comments that it can take bit of time to become RoTE accretive. I know some of the costs will get netted against revenue but, to the extent there is operating cost, can I just check that would captured already within your base cost guidance for next year?

**Tushar Morzaria, Group Finance Director**

On capital, we’ll probably keep on giving you, if you like, a real-time sense of whereabout our capital level will be targeting. I think, for now, we’ll probably stay above our 14% range.

On some of your precise questions, if countercyclical buffers were to be reintroduced, which they will be by the sounds of it at some point soon, our range was specifically designed to assume a normal level of countercyclical buffer, the kind of stuff that was operating pre-pandemic, and we should be comfortable within our range in that scenario.

[...] It is more about our own bank-specific risk tolerance or where we would like to sit, rather than a regulator nudging us one way or the other. I think the 13-14% is where we generally feel we need capital to be to run the bank, so you would expect us to move back into that range at some point.

Probably, if we’re sitting here this time next year and there’s no new variant and lockdowns are behind us and we’re on a normal economic cycle, then I’m sure we’ll update you – that’s what our thinking is around capital. I’d say for the next three or four quarters, I think we’ll need to see all these government schemes unwind. We’ll have to make sure there is no fourth wave over the winter, all the kind of things we would necessarily be just a little bit cautious about, but things look okay at the moment.

On US, if we had additional new partnerships, it certainly wouldn’t be included in the guidance, but the ones that we’ve already preannounced, you should assume are included in the guidance that we’re giving. The only caveat I’d put on all of this is, as Anna mentioned, if things are really good, there are volume-related costs. So, we wouldn’t hold back. If we can open more new accounts and the credit fundamentals look good and people are spending more and economies are surprising to the upside, we wouldn’t hold back, whether it’s the US or the UK.
So, I always put that little bit of caveat out there, that it’s a function of economic activity as much as everything else, but at least for guidance purposes for now, assume that the pre-announced deals are included. But anything new that we may do, and I’m not suggesting that we’re going to do anything, but if we do add partners into the portfolio and if we’re successful in doing that, then we will be over and above this guidance.

Rohith Chandra-Rajan, Bank of America

I was wondering if I could follow-up on your earlier comment, Tushar, on being a solid incumbent in investment banking. What we see from the major US banks is that they continue to allocate more capital to investment banking. So, I was just wondering about your appetite to do the same, if you want to maintain or grow market share in that segment.

Then, thinking more broadly, CIB overall is now 63% of group risk weighed assets, up from mid 50s a couple of years ago. Some of that obviously will reverse as consumer credit picks up but I was just wondering how you think about the balance between capital consumption amongst the divisions over time.

Then, just a quick second one on CC&P. Thanks very much for the comments earlier on, on the J curve. I was just wondering if you could give us an indication of the timing of that tipping point moving through cost of capital. Is that year two, or year three typically? I guess it varies from deal-to-deal but just a sense of that would be helpful.

Tushar Morzaria, Group Finance Director

I’ll say a few words on your questions on CIB and capital allocation, and I’ll hand over to Anna on CC&P to talk to you about the J curve timing.

On the CIB capital allocation, diversification is important to us across the group. We’ll be tactical within that. You’ve seen us do that over the last year or so where we’ve tactically deployed more CIB capital, given the buoyancy of the environment, although if you look at something like Q2, it is not a given that you need lots of capital to necessarily drive your top line upwards.

If life was that easy, as I joke with some of our investment bankers, we’d pay you like a mortgage banker. Human capital is probably as relevant as financial capital in the CIB, but having said that I think seeing the consumer side grow and probably holding CIB roughly where it is would be a nice outcome for us.

We’re not convinced we need to keep on deploying additional capital to grow. You’ve seen that. You’ve seen us hit record levels of profitability without really significant additions of capital, so I think it is as much quality and velocity of balance sheet as it is this absolute quantum that you need to carry.

The good thing about the IB, it’s a very fast velocity business, so you can deploy capital very nimbly, very quickly and then withdraw it pretty quickly, as well. We never pass up those opportunities but structurally we want to keep the right balance in the group. Anna, do you want just touch on the timing of the J curve in CC&P?

Anna Cross, Deputy Group Finance Director

Yes. It is a really difficult question to answer because it does actually vary deal by deal, depending on the exact economics. I think it’s really difficult to comment on the timing. What I would say, though, is that where we have a transaction where we are taking on a back book, as well as the future flows, that’s very helpful because obviously you are acquiring a mature book which is already in its peak RoTE, if you see what I mean, at the same time.

That helps to balance out some of these acquisitions. So, I would say new flow is dilutive. It depends on the exact partner that we’re dealing with as to the timing but where we’re taking on a back book simultaneously, you should consider that to be helpful to the economics.

Rohith Chandra-Rajan, Bank of America

Okay. Thanks so the AARP and the Gap acquisitions, you’re obviously getting the back books with those.
Tushar Morzaria, Group Finance Director

Yes, unlike Emirates which is only a front book portfolio. So, yes, the back books are going to be helpful for those deals.

Rohith Chandra-Rajan

Could I just come back on the IB, Tushar? One of the successes of the last few years is you do look to significantly improve the capital efficiency of the investment bank and largely close the gap with peers. Do you feel there is still more to go from a capital efficiency perspective or a balance sheet philosophy?

Tushar Morzaria, Group Finance Director

I think it is going to get harder. One of the things we look at is revenue divided by risk weighed assets, and on our numbers we think we score really at the top end there. Actually, on return on assets, we’re probably not quite as efficient as some other IBs, so there is probably something for us that we’re looking at there.

We’ve probably spent a lot of time and effort to be really efficient as we’ve designed the bank to be bound by risk weighted assets. But, efficiency on leverage is something that we’re going to take a long, hard look at and that will be helpful. But, I think we feel reasonably productive on capital at the moment, on an RWA measure, really.

Martin Leitgeb, Goldman Sachs

Just one question. Looking at the deposit inflow in Barclays UK, both retail and corporate, over the last 12-18 months, how do you think deposits likely to progress from here? Will we see stabilisation as the economy opens up further and hopefully returns to normality, or could there be a scenario where you would expect that deposits to potentially normalise, and we would see outflows over a continued period of time?

Tushar Morzaria, Group Finance Director

We think that the expansion of deposits on the balance sheet is really just a function of M4 money supply. There is an expansion of the monetary base by the Bank of England and fiscal authorities. Unless they take steps to soak up money supply, I think ultimately that money will sit somewhere on bank balance sheets.

It may rotate a little bit away from consumers and more into corporate balance sheets or even into financial assets ultimately, but we don’t see that money supply contracting. That’s why we think there’s probably more of it that is not transient, that sounds like a double negative, than perhaps we were thinking earlier on and we guided to. Maybe we’ve got more hedge capacity than we first anticipated, and we may make use of that but that’s the headline there.

I know we’re out of time and I imagine there may have been some other questions. Chris and the IR team are always available, and if you need help with models or various other bits that you didn’t get around to ask, Thanks for joining us. Take care, everybody.
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