

Barclays PLC Q3 2022 Results**01 November 2022****Analyst meeting transcript (amended in places to improve accuracy and readability)****Anna Cross, Group Finance Director**

We're really pleased with our results from last week. Not only with the financial performance of the Group, but that the matter with the SEC is now behind us. That was good to get that all closed off in the quarter and materially in line with the numbers that we've previously given you. Overall, we saw continued strong income momentum and returns across all of the three operating businesses. Group PBT was £2bn, RoTE was 12.5% and we reiterated our target of greater than 10% [RoTE] for FY22.

On income, I'm going to exclude the over-issuance, it's practically net-neutral at a PBT level but it causes a bit of noise [in the income and cost lines].

Income was up 17%. With BUK up 17%, we see continued benefit coming through there from rising rates, both in terms of product, but also in terms of the structural hedge, and we gave you some guidance as to how those two things separate out in the quarter. CC&P income was up 54%. Of course, the big part of that is US cards, which is growing as we expected it to, organically and inorganically. But the other parts of CC&P are also growing, so you're seeing good traction in the Private Bank and also in Payments. Really, really pleased with that. Then of course CIB up 5% and the knockout number within there was again FICC. But we shouldn't forget the strong performance that we're seeing pretty consistently now coming through in Transaction Banking, which obviously we expect to continue [given rate rises].

[Operating] costs, again excluding the over-issuance, were up 14%, impacted by FX, by our investment plans, and also by inflation. That manifests itself in different places, in different ways, and you might want to talk about that, but that means that we've got positive operating jaws of 3%. We reiterated our [cost] guidance of £16.7bn for FY22, essentially with that increased FX pressure and some inflationary impact, offsetting the positive that we've seen in the quarter in terms of the L&C [credit].

Turning to impairments, the Q322 Group credit impairment charge was £0.4bn. We did reflect a refresh of our macroeconomic variables in the quarter, a more cautious set, and we had an offset from the PMA for economic uncertainty. That's obviously why we put [the PMA] in place, but we're not seeing any significant signs of stress at all, across any of the portfolios, and the coverage ratios are very strong.

We did call out that based on the sensitivity analysis that we published in the [Results Announcement], Downside 1 would be covered by the £0.7bn PMA that we have in place. Probably the other notable points would be that US and UK cards stage 2 coverage was at 35% and 29% respectively. Both well above the pre-pandemic level.

We gave you a broad [impairment] outlook statement, which is that we would expect to revert to the historic loan loss ratio of 50-60bps over time.

On FX, we provided you some additional disclosure this quarter, so you can see the proportion of our costs, roughly 30% in US dollar, and between 40 and 45% in US dollar on the income line. Assuming the dollar/pound exchange rate stayed at 1.12, and it's obviously recovered a little bit since then, we'd expect our FY23 income to be £1bn higher and costs to be £0.5bn higher, roughly in that ballpark. That's hopefully a bit helpful as you model FY23.

Then lastly, on capital. The Q322 ratio was up 20 basis points to 13.8%. We managed the fair value impact from rising rates well within that and stayed within our target range. We called out that we have returned 15.35p to shareholders per share this year, thus far, equivalent to a yield of around 10.5%. I'm going to pause here to take your questions.

Joseph Dickerson, Jefferies

Just a quick question on FICC, and probably Equities could wrap into that. The SLR (supplementary leverage ratio) is becoming quite a limiting factor now for the large US banks. What do you see as the opportunity in the financing businesses, so Fixed Income Financing (FIF) and Equities Financing? Is there more leverage exposure you could allocate to that, and find [leverage] savings elsewhere to drive higher returns, and does that factor into thinking about 2023 to 2025 for IB businesses?

Anna Cross

In terms of the Fixed Income Financing and the Prime business, they're growing quite nicely over the last few years. That's largely because of the investment that we've put behind it, in terms of people, but Fixed Income [Financing] and Prime are also very reliant on an extremely robust operating system, very good resilience, and a broad range of products. It's a client servicing business. We feel that's been the cornerstone of why we've been able to pick up share, perhaps as others have stepped back. It's RWA-efficient, but as you say, a bit leverage heavy, so we are thoughtful about how we grow it. But we see it as an opportunity because it provides us stability to the CIB revenue on both counts. Obviously, in Fixed Income Financing in particular, as rates have risen, we've seen some widening of margins. Now that widening might slow down from here, we might expect it to, given the competitiveness of the market, but it does feel like a business that we're good at, and that we can continue to take share if others choose to step back. But we are thoughtful about the leverage burden that it puts on there. So that means we need to have the right clients, we need to have very rigorous margining in that business. So, we'll see how it goes.

In terms of the Prime business, I would say that's a bit less of a historic business for us. We've always been really big in Fixed Income Financing and obviously the momentum's come back into that business now, not least with the margin. Prime may be a bit more to grow out, but we are thoughtful about the way we grow it.

Joseph Dickerson

Just to clarify, that does explain some of the share gains that you had, relative to some of the other peers?

Anna Cross

Yes, that's right.

Alvaro Serrano, Morgan Stanley

Just a couple of questions. One is quite detailed and the other one more about capital returns. On the marks on the leveraged loans that you're taking through the Corporate Lending line, I think it was £190m this quarter, can you help us think about what to expect in the next few quarters, how to model that going forward, as it's a pretty chunky number? Also, contextualise that with the 35% first loss coverage that you've got, how do we think about that going forward?

Second, on capital return, capital was probably better than feared in Q322, but you've still got a pensions top-up in Q422, and we are not out of the woods in terms of the uncertainty. It does look like, in terms of [consensus], close to £1bn of share buybacks in the second half. Are you comfortable with that and should we be mindful of the [macro] uncertainty when it comes to distribution at year-end?

Anna Cross

Let me start with the leveraged loan position. We took marks at the end of the third quarter, and you can see that we obviously took some marks [also] earlier in the year because we gave you the year-to-date [number]. It's been relatively modest thus far. You can see that from the scale-up, obviously after the impact of the hedges that we've got in place. It's quite difficult to call a forward number because obviously if I thought there was one, then we would've taken that at Q322. It's difficult to tell [in advance]. Also, this is a market that can be a bit lumpy. We saw a window in August where quite a lot of deal activity cleared and cleared at reasonable prices. Let's wait and see what happens over the next few weeks and months. It's difficult to call a forward view on that, so it's something we're extremely mindful of, and we've managed our risk down in that book across the year with this kind of "hiatus" in mind, with a bit of stickiness in the balance sheet. So, we're very focussed on it.

In terms of the first loss [protection], that's actually different. Within the Corporate Lending line, there's a few things going on. There are obviously the marks, there's the cost of the syndicate hedges that go against those marks, and they're the two offsetting pieces. Then I'll come to first loss in a minute. Those syndicate hedges are largely tail hedges. We get some offset, but they don't entirely offset in the context of the markets we've seen thus far. But if you recall, going back to COVID, when we saw some really extreme movements, then they were extremely effective. They're largely for more tail events.

But then we have this first loss protection. Think of that first loss protection more for ordinary way, corporate and institutional clients' lending, so big IB lending. That's where we are essentially selling the first loss portion to a group of investors. We found that that's something we're able to do well out of our own IB. Investors like that, and we've found a continuing demand for that product. What it does, is it protects us in terms of credit losses that we incur on those books. We have found that to be very effective over the last few years. When you see us report a single name, quite often that is net of a first loss protection we get from that. But the [running] cost of that first loss protection is also going through the Corporate Lending line.

I guess this is part of our somewhat cautious risk appetite that you've seen emerge over the last year or so. You've seen us have a greater level of that first loss protection. We've gone from mid-20%'s to 35%, and on an exposure at default level it's more like mid-40%'s protection. Then if you look at the syndicate loan pipeline, we've chosen to hedge more of it because our appetite for stress loss has declined, and obviously the cost of hedging in the current environment's gone up. That's really what's going on in that Corporate Lending line. It's a bit of marks, but then there's also our risk management activity. Corporate lending underlying all of that, is actually quite stable. Hopefully that's helpful. Sorry, what I should say about that first loss is, although it's c.35% across the whole portfolio, if you were to go to specific sectors, it would be higher than that. We try and use it to target [higher risk] sectors.

In terms of capital returns, we were pleased with the 13.8% [CET1 ratio]. For us, really, it's a question of confidence in terms of capital generation, and what do we see at that point in time? At the half-year we were at 13.6% and we chose to do a buyback. I think there were a few folks out there who were perhaps surprised by that. That decision was based on our confidence in generating capital and getting ourselves back to the position that we are now in, so that's what we expected to happen. When we make our decisions, and we will make them at the end of the fourth quarter, going over the year-end, we will be looking at our ability to generate capital. Of course, the individual pieces, like Kensington [Mortgages] or, for example, pensions, will play into that decision. But pensions, for example, is a tiny point. What's more relevant to us is what's the capital generation capacity of the bank?

That will be informed at that point in time, as it always is, by the macroeconomic environment around us. That may be the same as it is now, which might lead to one decision, or that may have deteriorated, or it may be better and we may have some uncertainty behind us. It's quite difficult to call it right now, but that's how I'd think about it. What do we think about our forward earning capability as a business, and how does the environment that we're sitting in inform that?

Ben Toms, RBC

Two on costs, please. When I think about the bridge for costs next year and salary inflation being a large moving part in that, if I think about the salary inflation that happened this year, what's the right way to think about that? Should I be looking at the negotiations that happened last January and thinking about that, for the full year, including the top-up? I think Venkat has described that top-up as almost a pre-payment for next year. I just want to understand those moving parts, without you prejudicing any negotiations that might be going on.

Then, when we talk about costs for next year, I think Barclays has had more of a focus on the positive jaws story, rather than keeping costs absolutely flat. Can you just talk a little bit about how you think about that jaws story, in the event that rates came back down, and the revenue environment isn't necessarily as good, and how you then control the costs?

Anna Cross

We are just starting our negotiations now, in terms of those who are unionised, so difficult to call. But you're right to think of that [£1,200] as a pre-payment and of course that's already in the run rate of BUK from now on. That's where a large part of it sits, there'll be some in Corporate as well, but BUK would be the largest part of it. In terms of salary inflation, I wouldn't necessarily think about it as completely flat through the grade structure. Of course, we'll be very focussed on our more junior grades and particularly move up that group of people. A large part of what we'll be doing will be going through that model over the next few months, but it's difficult to tell. I would say think of it as probably

more skewed towards more junior colleagues. And you should think of that as a pre-payment in the amount that we've shown so far. There's lots in the papers about where various union settlements are coming out and you can make your own judgments, but we haven't finished those negotiations yet, so I can't say anything further.

In terms of jaws and how we think about it, the answer is it's different by business. Our cost strategy is two-fold, I would say. The first is, as we've said for a while, we're balancing inflation, efficiency and investment. That balance of those three things will be different in every single business. That's because of the second part of the strategy, which is we're putting the weight of investment behind the three strategic priorities. Those two things are really important.

In BUK, you can see the cost discipline there. And it's part because of what you're describing. The income tailwind it has, yes, there's increased transactional activity and a bit of extra mortgages, but in large part it's interest rates. Our focus there and why we took the [structural cost actions] in Q421, was to transform that business, make it more efficient, more effective. But you're seeing that as an offset to some of the inflationary pressures that are coming through, with BUK cost growth in the quarter of 3%. We're very focussed on that sort of shape for BUK. We'll see where we end up but think of that business as our investment being focussed on efficiency and effectiveness and disproportionately on cost takeout, to neutralise the impact of inflation, as opposed to necessarily volume growth.

CC&P is different. In CC&P we've got strong volume growth. That's both organic - and organic growth costs money because we have to put marketing behind it (obviously, there's contra income after that, but starting off with marketing - so, expect to see that continue, subject to the macroeconomic environment - obviously if it deteriorates, it's a setback from that); then we've also put down a lot of costs this year in respect of GAP. There'll be some ongoing tail of marketing for GAP, etc., but we've taken quite a big step change in respect of that this year, but I'd still expect to see cost investment in that business, but more than offset by the volume growth that we're getting on the cards side.

Then the CIB's a little bit different again, obviously less impacted by the rates point that you called out, although back to [Joseph Dickerson's] question about Fixed Income Financing, FIF is impacted by rising rates, it's where we get the higher margins from. Obviously, you also see it in Corporate, in Transactional Banking [specifically], so there's a bit of margin widening there.

But really, our investment pathway in the CIB is being focussed on building out capability. Actually, if you look at the jaws of our CIB, it's very similar to the US peers in the quarter. We may be a little bit more beneficial, that may be currency mix, but we're low negative-teens, whereas they would be higher. You can see that investment through the quarter. In that business, I would say we do have levers. We've obviously got investment prioritisation that we can pull back on and reshuffle, etc., and obviously that's where our performance costs are concentrated. So, there are some levers in there as well, but we are mindful about the rate tailwind.

The last thing I would say there is that one of the reasons that we pursue the [income] strategy that we do around the balance between hedged and not hedged [balances], is so that we can lock in that interest rate benefit as we go. We think that's quite important because that pathway might be shallower, might be shorter than we think. If you think what's happened to the yield curve over the last three weeks, it's quite dramatically different. We think that that strategy is, again, part of our risk management around the income line.

Ed Firth, KBW

Can I bring you back to credit [impairment], which is something that we're all looking at, at the moment? I'm still struggling to square this idea from all the banks that this is effectively the best environment we've had for banking in 50 years probably. With what you see from governments, from Citizens Advice, if I speak to IFAs, if I speak to Nationwide, a big house price drop for the first time. If you'd have given me those [points] separately to talking to you guys, I wouldn't have thought that was a fantastic environment for banking. I'm just trying to get it square, is it that you now just don't deal with customers that get into trouble, or that your systems are so good now that you feel comfortable that, even with your market share, you can separate out the wheat from the chaff, so to speak? Or is it a timing issue, or is it a bit of both? How do you think those two, which at the moment are the widest I can remember in my time covering banks, those two dialogues, how do you feel that those [reconcile]? At some point they're going to have to come together, and I'm just trying to think when do you think that will be, and what are the stresses that we might see as that happens? Does that make sense?

Anna Cross

Yes, it does make sense. The way I try and think about it is there's a difference between affordability pressure and credit risk. To a certain extent, some of the dialogue conflates the two. There is certainly affordability pressure out there, absolutely certain. You can see that intensifying, as well, [for example] if the energy price cap does reverse in April, that would take the average [energy bill] from about £2,500 over to £3,500, I think, which is not insignificant for households. Although, only around a third of UK households have a mortgage, and then we get a proportion of those who will be refinancing in this environment, for those people it won't be insignificant.

Then again, even though unemployment is very low now, there is clearly a risk of all this pressure building into the corporate area with increased unemployment, that's what we're all forecasting to varying degrees. Then we'll get further clarity on 17th November from the autumn statement. All of that would indicate that there is pressure in the system. But then if you go to the balance sheets, whether that be customer balance sheets or our balance sheet, they're quite different. If you take that environment and you [were to apply it to] where the balance sheets were pre-COVID, you would be getting a different response now.

Customers have had the opportunity to live in quite a different world [through COVID], and pay down their debt. We've never done a stress test where you lock people in their houses for six months. That's never been part of any scenario, but that's what we did, essentially. We've got high levels of repayment at every level of the risk spectrum, all the way through. We've got [relatively] low levels of unsecured lending. We've got house prices that have gone up over the last few years, so even if there is a correction, it would have to go quite a long way to get them back to the pre-COVID level. So, they're in quite a different position and I think the banks are too. To a certain extent, there is a timing point here, I think, but there's also a quality of balance sheet point.

The other thing that we think about is when customers are taken by surprise, and the reason why we tend to use unemployment as a trigger in an impairment model, is that unemployment is shorthand for a very rapid change in your disposable income. That's really what it is. A rapid change in unemployment causes untold damage as a credit matter, but clearly that's not what we're seeing now. We're seeing low unemployment, and very high levels of employment. Customers are feeling an affordability squeeze, but they've definitely got a run at it, there's been some time for adjustment, and we can see them adjusting. They are changing their spending habits, they are repaying their credit cards far more than they need to, [with the result] that our balances are at best flat, as an interest earning matter. We can see them repaying their mortgages very quickly, and overpaying. All of those adjustment behavioural signs are there, so it feels like there's a bit of a waiting game, but there's also a quality position.

Ed Firth

Just a follow-up to that. Is there a risk then, that if everybody is in a much better position, in terms of getting inflation under control, we may have to foresee that interest rates actually stay high for perhaps a little bit longer than people are expecting? Because in a sense, it seems to me we can't get through this, you can't control inflation and have no credit cycle. It's almost like one or the other. I'm just wondering, if we were to see rates, not so much going much higher, but persisting much longer, does that have a big impact in terms of how you look at credit?

Anna Cross

I think that's an interesting question because, to a certain extent, that adjustment by customers right now, you would think is anti-inflationary. They are adjusting their spending now. If you look at pretty much anything non-essential, the only non-essential that they're really increasing their spending on is travel. Everything else is reducing. It's definitely having an impressive impact on customer demand, which I guess is the idea. And we'll probably see that intensify as more people switch, etc., so we'll have to wait and see. At current rates, most customers have been stressed at these rates and well beyond, when they did their initial affordability, so it shouldn't be a significant stretch if they stay here. Having said that, it's really difficult to do averages of averages. There will always be some customers for whom the combination of the mortgage and [other items], puts them under pressure. But as a wholesale matter, if you like, at current rates, our customers, and pretty much everybody since 2014, will have been stressed at a significantly higher rate than the reversionary rate that they would've gone onto. They should, in theory, be able to afford what they're currently experiencing.

Rohith Chandra Rajan, Bank of America

Could I just follow up on the Corporate Lending line, please? Just in terms of that risk management piece. If we put leverage loans to one side, and we think about the first loss protection plus hedging versus the underlying

performance of the business. How far through that risk mitigation process are you? Is there further to go in terms of putting more hedges on at some cost that'll offset the underlying performance of the business?

Anna Cross

At this point, in terms of the syndicate hedges, we've obviously managed the book down as well, so I wouldn't see us going much further. The other side of it is, in part, determined by investor appetite, which remains quite strong, but also, the extent to which we continue to grow our corporate books. Which might be relatively muted in the current environment, you might expect. I think we're in a good position right here. It seems like we've done a good level of adjustments.

Rohith Chandra Rajan

Then on Transaction Banking, a very strong performance there, up 57% year-on-year. Could you help us break that down in margins, volumes, underlying business activity?

Anna Cross

I won't split the numbers out for you; however, you can see there's a few things going on there. Firstly, [deposit] balances have continued to grow. We've obviously seen some margin widening there, but for us, certainly, the amount of margin widening that you see in corporates is less than we see in the other books, [specifically] corporates with multi-bank relationships. That's important, there's some margin widening, but not to the extent that you would've seen in a retail book. Then there's also an increase in nominal economic activity. Whether that be foreign exchange payments, whether that be trade finance, or payments more generally, etc., you're going to see an increase in that fee line also going through Transaction Banking. But this is a very stable source of income for us. It's the oldest part of the bank, a really key part of the franchise, so one that we are very focussed on investing behind, as well. We've done some investment in the cash management system. And our ability to manage clients cross-border, not just the UK or the US.

Rohith Chandra Rajan

On the margin piece, that's because you effectively pay wholesale rates to your large corporate clients, or close to?

Anna Cross

If you're a large corporate and multi-banked and you've got a treasurer managing your money, then your ability to move your money around and get the best rates is fairly easy. Also, these are really important clients to us; they are, as I say, a key part of the franchise. From our perspective, we see them looking and getting the best rates.

Martin Leitgeb, Goldman Sachs

Can I just ask on the outlook for volume growth in the UK, just to touch on some of the earlier comments made in terms of customer behaviour? How should we think about volume growth for mortgages and credit cards in the UK, and equally, deposits? Could there be a shift in behaviour so that balance growth could be very muted or even negative in some product areas? Related to that, I was just wondering if you could comment on the risk appetite of Barclays, both in the UK and in US? Previously, as we entered recovery, there was some sense of Barclays leaning a bit more into the recovery, given the more cautious approach post-Brexit. Is that still the case or is it a bit more cautious now in terms of risk? Similarly, with regards to your outlook on US cards, you previously talked about partner fees, and partner fees getting increasingly difficult from a pricing perspective, is your appetite still there to do such deals and could there be a better outlook now?

Anna Cross

Okay, let me take the first one. In terms of volume growth, I would say we should expect it to be more muted, and that's for a few reasons. Definitely in liability growth, we've seen that slow down, as you might expect in the current environment, across both personal and SME. There's still some growth in corporate, but again, you'd expect that to slow down over time. In terms of mortgages, in the current market, you would expect it to be dominated by re-mortgage activity. We're already starting to see that switch. Re-mortgage activity is a low net growth activity. House purchase activity drives strong net growth, re-mortgage is low net growth because it's essentially a recycling effect. In a rising rate environment and in an uncertain environment, where house prices are under pressure, you'd expect

fewer first-time buyers. In terms of the market, you need first-time buyers in order to have a really strong house purchase market. So, think of it that way. That has implications for mortgage profitability in terms of churn, etc., so we're thoughtful about that.

In terms of cards, we might see total balance growth, but interest earning lending [growth] in the current environment you would expect to be quite muted. And actually, we're okay with that. At the current point in the cycle, that feels like an okay place to be. In terms of risk appetite, you're right, we were cautious coming out of Brexit, we were cautious going through COVID, and probably a bit slower to turn on than some of our competitors. We haven't made wholesale changes to risk appetite yet. The reason for that is simply because we don't see active signs of distress in the book or, more generally, across the economy. Now clearly, that doesn't stop us from updating our affordability assumptions, which we've done twice this year already, given the momentum in inflation. So, think of it as a more individual customer decision. We'll wait and see what happens and then that may or may not move. Having said that, customers demand, if you just think about what customer demand is going to be like for high LTV mortgages in a re-mortgage market, you'd expect that to be muted. I think there'll be a reduction in risk appetite by the customer and we already see that.

In terms of the US, we're very focussed on onboarding GAP well. That is a significant addition for us. Clearly in balance terms, but more so operationally - 9 million additional customers, that's quite a thing for us. At the moment we're pausing and learning, and onboarding and embedding that, so I wouldn't anticipate we would take on another big partner immediately. We've said that for some time, but that's not really a risk appetite [matter], but it's an operational risk and decision. We think it's important to show that to be a success and then we'll move on.

Andrew Coombs, Citi

Two from me, please. Especially with what's going on with CC&P, if I look at the two revenue lines, quite diverging trends Q-on-Q. So NII up strongly, presumably due to GAP, FX translation, but fees did come down quite substantially, so presuming there were some one-off fees in Q222 you didn't draw out at the time. Second question, just on IFRS 9 calibration. If I look at your US scenarios, you've taken quite a big step change. In your UK scenarios, you look to be the only UK bank still looking for, on blended average across your weighted scenarios, positive GDP growth next year. I think you're looking at unemployment at 4.5%, nowhere near 6%. Any thoughts on exactly how you calibrate your IFRS 9 scenarios, what external factors you're using in the inputs, anything that would be helpful?

Anna Cross

Let me start with US cards, it's relatively straightforward. It's more about the current quarter than anything else. In the current quarter, you've just got some initial costs or contra income of GAP going through there. I'd expect to see some recovery into the fourth quarter.

Andrew Coombs

And that's through fees, presumably, then? And any quantification, any way we can frame that?

Anna Cross

I wouldn't disclose it. That line can be a bit lumpy, particularly when you're taking partners on, or indeed off. Just think of it as a multi-quarter trend.

In terms of the UK [macro] scenario, we have a well-defined model process. The scenario that we use is consensus and we snap consensus at a particular point in time. Secondly, the way we weight it is that we weight the scenario using historical probabilities. You currently have a Baseline Scenario using historical probability. So, if you currently have a Baseline Scenario of X percent, what is the probability of getting to Y percent? That might be the Downside One [scenario]. They are a modelled output for us. To the extent that we have concerns about whether or not consensus is effective or is moving quickly, because clearly, the MEVs is one part of a very long modelling process, it's how your models will react to those MEVs, that will be different by business. How you weight your scenarios, again, that will be different by business. Then again, we've obviously got a fairly hefty post-model adjustment and it's reflective of all of those things together. I appreciate that looking from the outside in, it's quite difficult. Because when you take the three bigger banks, we've all gone about it in a completely different way. The only consistent output you have is coverage.

Omar Keenan, Credit Suisse

I wanted to ask about rating migration. If we think about capital planning and organic capital generation for next year, can you help us think about what the potential moving parts are on RWAs. For example, if we have a fall in house prices, what that might do to mortgage RWA? Any key sensitivities in the book, for example the corporate book? I don't know if there's a good rule of thumb to think about, if you have the book downgraded by one notch or something, can you help us size what the potential movement in the RWA is around next year? And could you help us with the sensitivity for the FVOCI assets? I can see that's been managed down quite a lot.

Anna Cross

I'm not going to throw numbers out here, but let me help you think about it, perhaps the way I'm thinking it through. On RWA, there's a couple of things to think about. The first is the pro-cyclical impact on the RWAs itself. Typically, what we expect to see happen first is credit, followed by counterparty credit and then sometimes we get some market RWAs. In credit RWAs, you've got two offsetting things going on in there. In the current affordability environment, there is definitely a probability of default intensification, so you would expect that to deteriorate over time. There's also a Loss Given Default (LGD) impact. Now there, customer behaviour is really important because we've obviously seen LTVs fall. And remember, mortgage losses are highly non-linear. So you're not really going to get a big LGD issue, unless [house prices reductions] go a long way down that curve. In which case, it kind of does that. Similarly, in cards, with paydown of cards balances, the loss given default in cards is also a little bit more muted than perhaps it has been historically. So that exact mechanism, you've got two slightly offsetting pieces going on in there. The counterparty credit risk is a bit more lumpy. That will be in relation to large counterparties being re-rated. To the extent that we see that starting to happen, you'd see that emerge in lumps.

Market RWAs tend to respond to shocks, so if this is a slow burn recession, you wouldn't necessarily expect an impact there.

The other thing of course, that we might be watchful of is the extent to which EL (expected loss) exceeds impairment. In a real recession, we wouldn't expect that to happen. In a benign time, they should be roughly equal. In a recession, what happens is, as you build Stage 2 and Stage 3 balances in impairments, they go to lifetime loss [from one year], in the EL model they're still 12 months [expected] loss, so you should see your impairment escalate above EL, so we shouldn't see that drag. It might be slightly different by portfolio, but we'll be very watchful for that. That's the RWA inflation point. We might see some RWA inflation. I'd expect to see it in credit first, but given the other behavioural aspects, we might see some modification of that versus what we've seen before.

In terms of FVOCI, what we've had in the quarter and actually in the year-to-date, are some quite extreme moves in the yield curve. Even prior to that, we started managing down the fair value exposure we had in that kind of product and increasing the diversification. That's why the impact in the quarter was about 12bps, so not as significant as perhaps you might've thought from the outside in. There will be a point from here where we judge that it's appropriate for us to start re-entering some of that market. We might choose to change the mix of our investments in our liquidity pool. We're not quite at that stage yet, given the volatility. We'll give further disclosure on that at the end of the year, and you'll see how it's changed, we can talk to you about how we're continuing to manage that book. We made a decision at the beginning of the year that we expected to see some volatility, so we started taking those positions down pretty much all the way through the year. And you see some lumpiness in it in prior quarters, but remember, Absa was in there as well, so that's part of what you need to go through there.

Chris Cant, Autonomous

If I can just ask about IFRS 9, please. I'm a bit like Ed Firth, I'm struggling to understand how the commentary sits with the deteriorating macro-outlook. The first question would be PMAs, are they really, in part, just a COVID hangover at this point and should we expect this level of uncertainty PMA at a normal point in the cycle? In 3/4 years, will we still have this order of magnitude of PMAs, or is this really just a hangover from a really unusual recession that turned out not to be that? And you're just going to bleed them back into the P&L now over 2/3 years, or however long it takes. Or if next year things deteriorate, you say that's the uncertainty we were preparing for. As we come out of that recession then, do you rebuild them because you say the macro uncertainty's gone back up again, because things are good and it might get worse? Or do we just see them disappear into nothing? That would be the first question.

Then, again in terms of IFRS 9 and how it's actually going to operate as we go through a cycle. If I think back to 2020, and listening to Tushar Morzaria at this event, he talked about how IFRS 9 would tend to overshoot. As we ride the macro wave down, at no point until you hit the trough will you have conviction that all of the provisions you've built in Stage 1 and Stage 2 can just be moved into Stage 3 as things start defaulting, because you're just going to keep

worrying that things are going to keep getting worse. Is that still the view or have you refined how we should be thinking about how IFRS 9 operates as we go through a cycle? Do you still expect it to overshoot or not?

Anna Cross

I've got my strict technical accounting hat on now, which is to say that PMAs are there for two reasons. Firstly, if we think there's a problem in the model, you'll see that not all of our PMAs are economic uncertainty PMAs. Sometimes if we, through our annual model calibration, decide that it's not working quite correctly, we'll sometimes use a PMA. But then you'll see that disappear. That will be short-term, because when we then readjust the model, you'll see that drop out. Are they a COVID hangover? The reason why we had them in place for COVID, and you might recall they went in both directions in COVID to begin with, we had a situation where we were using PMAs to deteriorate the scenario. And then we used PMAs going the opposite direction, when we had government support because the models weren't trained to look for government support. Where we are now is, I think our judgement would be two-fold. First, how effective is the consensus, given the economic and some of the political backdrop we've gone through? We're making a judgement about that. And the second thing we're making a judgement about is, none of these models were built and calibrated in a high inflationary environment.

Back to the point I made earlier, unemployment is really a shorthand for a rapid reduction in disposable income. That's why we use it to drive unsecured models, in particular. Inflation can do the same thing; energy prices can do the same thing. That's how we're thinking about it, we're trying to adjust for the fact that we don't have as much inflationary data as perhaps we will do once we've been through this environment. And where we've built, or rebuilt models to be a bit more inflation sensitive, some of that PMA drops away.

So, there is a point in time here, but I think there's also a model sophistication point, just because of the time during which they were built. In peacetime, I would not expect there to be a large and enduring PMA because this is not a period of time where you have general provisions, where you just have them because you feel like you might want them. All of these things are calibrated and built and audited, and go through our own model governance. There's a high bar for us to create and maintain them. That's probably that piece.

In terms of how IFRS 9 behaves, it is pro-cyclical. The other thing that you have is that it's based on a set of macroeconomic forecasts, which may or may not come to pass. That's back to your point about COVID, the recession that never was. Simply because of the way it's designed, it's anticipatory. Also, stress tends to emerge in a particular order. I think you might see it operate slightly differently, portfolio by portfolio. If we go into a stress, you get wholesale related stress quite quickly, whether that be in Markets or in something like leveraged loans (although that's not under IFRS 9), followed by unsecured stress, followed by secured stress. Reaching the trough, if you like, doesn't happen instantaneously.

Raul Sinha, J.P.Morgan

If I can have two, please. The first one is a bit technical, but just around NII, and when we think about what we've heard from some of the other banks, they've talked about how the cost of funding of the trading book is booked in NII, as a contra NII. Can I clarify whether or not that is the case for you, so that we have an apples for apples approach when we model NII for all the banks?

Anna Cross

Yes, the costs of funding in the trading book are in the trading income line. My colleagues reminded me of page 347 of the annual report, if you'd like to have a look at the accounting policy, it is in there.

Raul Sinha

Related to that, if I look at Barclays International NII, which is not an area anybody spends a lot of time on, that is up 80% year-over-year. We can see what's going on in CC&P, but obviously the Investment Bank is having some very strong NII performance. Can you help us a little bit around how to think about the Group's overall NII? I suspect that might be a little bit of a focus going forward and, within that, the CIB.

Anna Cross

The CIB NII is a bit of a "lesser spotted" number, I think. The other thing to remember that's going through there is Transaction Banking. Corporate is in there, so that's a large part of what you're seeing. For example, Fixed Income

Financing, Prime etc., doesn't go through that line. If it's helpful in future, we could probably do a bit more of a focus on that, but a large part of it is the Transactional Banking and Corporate that you will see going through.

Raul Sinha

If that's all there is, then I do think it would be helpful to model that separately. Then maybe lastly, obviously we're hearing from all the banks that deposit pass-throughs have been very low, but I think we're at the point now where rates are at the level where they haven't been since 2007. Obviously now the velocity of deposits is much higher in the system, you have open mobile banking, and it's very easy to move money relative to ... 15 years ago. And yet, I think what we hear from most of the banks is that deposit betas/pass-throughs are only going to approach 50%. I'm just wondering whether or not you are seeing any increased migration in Q422? Are you seeing anything in your current quarter in terms of increased migration, and how should we think about this accelerating towards the ISAs [season]? Is this a seasonal deposit market, again as we go into ISA season next year? Is that really when we will start to see the real migration come through?

Anna Cross

I guess there's a point in the cycle where a pass-through becomes less relevant, and [deposit] migration becomes more relevant. You've probably heard me talk about product dynamics. That's essentially what I'm nudging you towards when I'm talking that way, because I think there is a powerful impact here. There are some slight offsetting impacts, you're right. Last time we had rates at this level, you had to queue to get your money out, now that doesn't happen, so people can move their money around a lot more easily. That clearly will have a dynamic. Probably a couple of things going on in the opposite direction. Firstly, versus the last time we were here, banks are far less reliant on wholesale funding, far less reliant on fixed-term deposits as a source of funding, which certainly created a degree of funding pressure on the liability side. I think the other thing is, in a slightly uncertain environment, people's desire to fix and lock their money is slightly more muted. That's clearly not true for everybody. The more sophisticated, wealthier folks who have a clear buffer, you might expect them to do that.

We do see some signs of migration, and, to a certain extent, we would regard that as healthy franchise [savings] behaviour and actually something we would encourage. We would want our customers to put aside an amount every month, or whatever, for a rainy day. That's certainly part of our relationship strategy within BUK. Actually, we've launched products, we've got a 5% rate Rainy Day Saver up to £5,000. The reason for that is £5,000 is roughly three months' worth of outgoings for an average family. We're trying to encourage that kind of [savings] behaviour with specific products that we think speak to the current environment. But the migration to those products is part of the reason that we think the product dynamics are a bit tougher from hereon in; and why we called out the distinction between the structural hedge dynamic and the product dynamic, because the product dynamic has led [so far]. From here on in, I think the hedge dynamic is a bit more powerful, if that makes sense.

Perlie Mong, KBW

Just two questions, one on coverage. I know you talked about Stage 2 coverage broadly, the two card books have gone up, but if I look at total coverage, almost all of the books have been down since pre-pandemic levels. I know some of it's just that there's less Stage 3. Are there any underlying changes in the books that might explain that?

Anna Cross

Customer behaviour. You can see in terms of proportion of Stages 1, 2 and 3, it's quite different from where it was and that is driving a difference in the overall [coverage]. Customers are repaying more, their balances are lower, their LTVs are lower. All of that is essentially leading to a [stage] migration [to the] left, if you like, towards Stage 2 and Stage 1.

Perlie Mong

So, it's not like a product change or something?

Anna Cross

No.

Perlie Mong

Then secondly, just wondering what your playbook looks like when it comes to a recession. What are the priorities in that playbook? Would it be focus on existing customers, and maybe not take on as many new customers, or maybe more generally tightening credit for everyone including existing customers? Or do you think it's a chance to support customers, or even take on new customers who might be otherwise very valuable customers, but might just need a bit more support in bad times. What's your priority in that playbook?

Anna Cross

We have what we call a recession readiness framework, it exists for every product. What that does, is it basically says what are the behavioural early-warning indicators that we are looking for? Increased overdraft usage, withdrawing cash on a credit card, increasing proportions of customers paying [only minimum payments]. You can imagine, there's a whole list of them. Essentially what happens, as we see them start to trigger, is we will take action. That would involve both new customer flow-in, and it may impact current customers. For example, it might cause us to withdraw certain products from the market. In terms of existing customers, we may manage limits. You'd expect all of that to happen. I guess what I've talked about before, though, in the current market, is the number of customers seeking to change lender, take out new facilities, I would expect that to be quite muted in the current environment. In part because the market will be dominated by re-mortgage. It's much easier to re-mortgage with your existing lender than go to a new one, that kind of thing. You think about the customer mentality, I wouldn't expect there to be a lot of moving around.

With Corporate customers, each of them is unique. The way we think about them is that we have particular, focussed sectors. We have sectors that perhaps we have more concerns about than others. Think about sectors that would be impacted by a rapid reduction in customer spending, discretionary spending. Or sectors that are particularly exposed to energy costs, for example. We're focussed on them in particular, and we look at, essentially, their liquidity. We're assessing them in terms of their liquidity and how they can continue to service their debt. But that's the process of watchlist migration and ultimately, to work it out is a corporate by corporate process.

Guy Stebbings, Exane BNP Paribas

The first question's back to IFRS 9. Effectively, Taking Downside 1 scenario as an example, there's a similar magnitude of difference to the macro-overlay PMAs, but it doesn't capture migration to Stage 3. I'm not expecting you to throw out a number, but were you to try to capture migration to Stage 3 as well, how much additional would that add to the ECL, or actually does it adequately capture migration from Stage 2, that does the heavy lifting, as it were. I think it's very nice, neat disclosure, but it's hard to know how much we should be leaning on it.

Anna Cross

Stage 1 and Stage 2 are largely behavioural reflections. Stage 3 are people who are really in default, or corporates that are really in default. You have to be 90 days down to get into that bucket. In our disclosures we don't migrate people to Stage 3, I'm not aware of anybody who does, actually. Our view would be that by the time you get into the far right, if you like, of Stage 3, we've captured the majority of the impact. In terms of the way we think about it, also, one of the offsets in terms of the movement of Stage 2 to Stage 3 as we charge and ultimately write off, there is a recovery element of that in terms of debt sales, that we and others would deploy. Typically, what we do is when we model a stress, we assume quite prudent assumptions around that debt sale activity. Although, our experience has been that we were able to continue that through COVID, for example. That provides some offset to the modelling approach that you see.

Guy Stebbings

I had a quick follow-up on mortgage lending. Obviously, it was very strange in the market around late September/early October. You would normally look to pre-hedge the business that you write, and to the extent we see swap rates jump up, it doesn't matter for spreads, as long as you can pass it on. But obviously, the market wasn't able to do at that point in time. I'm just looking for a sense of the volume of mortgage lending that went through the system, relative to the hedge that you would normally put in place, just to give us a flavour of how much business is written in the spreads or even negative spreads, during that very odd period, as it were.

Anna Cross

We would not go beyond our pre-hedge. I think you saw a lot of that activity happening during that period. What happened was big increase in the yield curve. So, two things happened. Firstly, if folks hadn't pre-hedged adequately, or to the extent of them bringing in demand, then you'd see them drop out of the market. We saw about 50% of products drop out of the market. Then you have two other dynamics that were going on in the period. It's such a competitive market that when people drop off, their volume just goes somewhere else. You end up with waves of operational activity that will go to another lender, plus customers were extremely anxious and trying to re-mortgage through that period. So, you've got demand concentrating in [banks] that were still left in the market.

Then there was a series of recalibrations as everybody hedged a bit more, nudged their pricing up, etc. And it's still settling down now, you can see that, and now it's started to drift back down again. I think you would've seen people withdraw entirely, if they had the issue that you described.

We manage between three things all the time. Firstly, what do we want our market share to be? That's typically about 10%, although it will vary by day. Our returns, and we run a very strict return hurdle, and [finally] our operational capacity. To the extent that any one of those is not hit, we would then make a decision to withdraw or modify or reprice products. But for us, in particular, we weren't taking on business that we hadn't pre-hedged.

Ed Firth

I'm thinking about deposit pricing and I'm just trying to think how we should look at that, because in one way you can look at it and say, and I know you've got lots of great offers, but broadly speaking, you're paying 40bps, base rates are at 2.25% and it's surely going to go up to 3%. That's one way of looking at it, but then the other way could be that you're paying 40bps, but most of that is hedged, so you're actually only getting 90bps or so. That's a comparison. I guess the implications of the latter is that as long rates go up and your hedge rolls, that's where we should start to see the 40bps, you'd start to pass more of that on to customers, and we won't necessarily see that just flow straight through. Which of the two is the right way of looking at that? I'm just struggling in my mind to think that through.

Anna Cross

Can I say neither? There are two potential strategies here: either you hedge less, in which case you're more exposed to that base rate going up and you've got more opportunity to manage your product dynamic and increase your margin in the short term. Or you can hedge more, in which case it's a smoother and more delayed impact. We've gone for the latter approach. The reason being that our objective (it's an income point, but it's also a risk management point) is it's there to smooth the income of BUK, which is the ringfence bank, systemically important, all of those things. So that it's not exposed to the volatility in base rates or, indeed, the yield curve. That's what it's there for, and that's why we've done it somewhat mechanically. It's not entirely divorced from our thoughts around product pricing, but don't think of it as when we get more hedge income, we'll pass it on to customers. The reason that we pull the two apart is just because of that we would see the product dynamic as one that is changing and potentially changing quite rapidly at this point in time. Whereas the hedge just continues to roll, so that will provide some continued momentum to NII. That's how we think of it.

Ed Firth

Does that mean that if the competitive environment for deposits becomes much more demanding, which I guess you would imagine with liquidity coming out of the system, could you actually be making a negative margin on those? Because clearly, overnight deposits could reprice very quickly and obviously the hedge is going to take five years to reprice. I'm just trying to think how those two dynamics work together.

Anna Cross

I wouldn't see it going that far. Remember, the majority of what we're hedging is a NIBCA (non-interest-bearing current account) anyway. That's a big part of it. But when we put a hedge together, we're mindful of [deposit] migration and we're actively encouraging it in the right way.

I think we'll draw it to a halt there. Thank you very much for your time.

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