FitchRatings

12 Oct 2020 | Affirmation

# Fitch Affirms Barclays' Long-Term IDR at 'A'; off RWN; Outlook Negative

Fitch Ratings-London-12 October 2020:

Fitch Ratings has affirmed Barclays plc's (Barclays) and Barclays Bank plc's (BBplc) Long-Term Issuer Default Ratings (IDR) and Viability Ratings (VR), and removed them from Rating Watch Negative (RWN). The Outlooks on the Long-Term IDRs are Negative. Fitch has affirmed Barclays Bank UK plc's (BBUK) ratings.

A full list of rating actions is provided below.

The removal of the RWN on Barclays' and BBplc's ratings reflects our view that the group's resilient 1H20 performance has helped reduce near-term risks to the ratings and strengthened the group's rating headroom at the 'a' VR level under our baseline scenario.

Barclays' 1H20 earnings benefitted from pandemic-induced market volatility, with strengthened investment-banking earnings, held within BBplc, offsetting heightened impairment charges and weaker revenues from the group's lending businesses. This supported the group's continued profitability to date, with reported 1H20 net income of GBP1.2 billion (-53% year-on-year). Continued net profit, combined with the cancellation of dividend payments, strengthened the end-1H20 CET1 ratio to 14.2% (+40bp on end-2019), including an estimated 75bp benefit from IFRS9 transitional relief.

We believe that improved capital buffers, coupled with loan loss allowances built up to date, will, in our base case, allow the group to absorb the fallout from deteriorating asset quality, profitability challenges and likely inflation of risk-weighted assets (RWA) at the current rating level.

We also believe that government-support measures in the UK and US have helped to delay, and potentially reduce, the full negative economic impact of the pandemic. This has supported asset quality to date - although revised economic assumptions under IFRS 9 have driven significant loan inflows into stage 2 - and allowed Barclays to build up capital buffers ahead of the expected roll-off of government measures from 4Q20.

In addition to strengthened resilience at the group level, BBUK's rating headroom is also supported by a more stable company profile, lower risk appetite and superior funding profile to BBplc's.

The Negative Outlooks on the Long-Term IDRs reflect downside risks to our expectations, in particular in case of a greater-than-expected weakening of asset quality, for example due to a materially slower pace of economic recovery than our current forecasts suggest.

## Key Rating Drivers

### BARCLAYS

Barclays' VR and IDR are based on the consolidated analysis of the group, and reflect our view of the group's capacity to generate adequate profitability, which benefits from its diversification and the resolution of legacy conduct issues. The group's sound capitalisation, funding, liquidity and asset quality going into the economic crisis also support the ratings. Our assessment of Barclays' company profile and risk appetite (both a-) are constrained by the bank's exposure to volatile and competitive capital markets and trading activities, which we assume will continue to be offset by strong and resilient financial metrics to maintain the current rating level.

Earnings had been improving prior to the onset of the pandemic, supported by lower restructuring and legacy conduct costs, and by a focus on reducing operating expenses. Return on tangible equity (RoTE) improved in 2019 to 9%, in line with the group's target for the year, and management continues to target a RoTE of greater than 10% over time despite short-term earnings deterioration due to the economic crisis.

We expect that earnings will be burdened in 2020-2021 by higher loan impairment charges, and by revenue pressure from lower interest rates and subdued lending volumes that are only partially offset by investment-banking earnings. Reflecting these dynamics 1H20 operating profit was GBP1.3 billion (-58% yoy) per Fitch calculations, due to impairment charges of GBP3.7 billion (close to double the charge for 2019), which translated into operating profit/RWAs of 0.8% (2019: 1.5%).

We expect the bank to remain profitable in 2H20, with lower loan impairment charges than in 1H20, although this expectation is sensitive to a further significant downward revision of economic forecasts. We expect profitability to remain subdued in 2021 as loans migrate into stage 3, which in our view will result in continued above-average impairments. At the same time, we believe that the group has the capacity to deliver operating profit in excess of 1.5% of RWA under more normalised loan impairment charges, and the ratings factor in our expectation that it will be able to achieve these profitability levels in 2022 at the latest.

Barclays' asset quality was sound going into the crisis and has remained resilient so far, supported by government measures in key markets. Deterioration is likely as these measures roll off although this should be partly mitigated by the group's conservative underwriting standards in domestic mortgages and corporate lending. Actual impairment cases have remained low to date with the end-1H20 stage 3 loans increasing a modest 27bp on end-2019's levels, to 2.8% of customer loans per Fitch calculations. At the same time, the bank's revised economic forecasts following the onset of the pandemic resulted in stage 2 loans almost doubling in 1H20 to 21% of customer loans and drove an increase in loan impairment charges to 186bp of gross loans for 1H20 per Fitch calculations, compared with 55bp for 2019.

Government measures to support employment and household incomes have so far prevented a spike in delinquencies in Barclays' consumer loan portfolios, which are concentrated in the US and UK. Coverage of performing unsecured retail loans by stage 1 and stage 2 loan loss allowances has increased to 7.6% at end-1H20 from 4.5% at end-2019, which should cushion impairments as loans migrate into stage 3. However, we still expect the group's unsecured retail loan book to remain a source of material impairment charges in the coming quarters given the severity of the employment shock and uncertainty around the speed of recovery.

Pressure on asset quality is also likely to arise from Barclays' exposure to leveraged finance, and to industries that are vulnerable to the economic disruption, most notably oil and gas, transportation, high-street retail and hospitality and leisure (in total GBP20.7 billion or 6% of total customer exposure), although we expect Barclays' conservative risk appetite and routine use of risk transfer deals to partially mitigate losses.

The end-1H20 CET1 ratio of 14.2% (+40bp on end-2019; 13.5% excluding IFRS9 transitional relief) was sound and comfortably above the minimum regulatory requirement of 11.2% (including a 0% countercyclical buffer, and a lower Pillar 2a requirement compared with end-2019). The benefits of IFRS9 transitional arrangements will reduce over time as loans migrate into stage 3 but we expect capitalisation to remain a rating strength. We do not expect the group's CET1 ratio excluding IFRS9 transitional relief to fall significantly below 13% in the next 12-18 months despite some possible RWA inflation as we expect Barclays to continue to generate adequate amounts of capital organically.

Barclays' funding profile remains well-matched and diversified. It benefits from the group's UK retail franchise to fund retail assets and good capital-market access to fund wholesale operations. Its gross loans/customer deposits of a healthy 73% at end-1H20 (compared to a 2016-19 average of 84%) benefitted from deposit inflows and subdued loan volumes during the period. Liquidity is comfortable, with a liquidity coverage ratio (LCR) of 186% (2016-2019 average: 154%) and an eligible liquidity pool of GBP298 billion at end-1H20, which are well above regulatory requirements.

The group is well-positioned to meet its minimum requirement for own funds and eligible liabilities (MREL) and at end-1H20 holding-company MREL instruments were equivalent to 32.4% of RWAs, compared with a 29.7% indicative requirement for 1 January 2022. The group has continued to issue MREL-eligible debt throughout the crisis and continues to expect issuance of GBP7 bilion-GBP8 billion for 2020. We expect any additional issuance needs to be manageable despite market volatility given Barclays' established wholesale-funding franchise.

Barclays' VR and IDR also reflect reasonably low common equity double leverage (107% at end-1H20) and prudent liquidity management at the holding company.

The 'F1' Short-Term IDR is the lower of two possible options mapping to a Long-Term IDR of 'A' since the group's funding and liquidity score of 'a' is not sufficient to achieve a higher Short-Term IDR.

BBplc and BBUK

The VRs of the two main operating banks, BBplc and BBUK, reflect their standalone credit profiles, which include the benefit of ordinary support from the group. BBUK operates a simple, domestically focused, retail and SME banking business model, and has stable funding dominated by granular deposits. BBplc is the larger operating bank by balance sheet and houses the corporate and investment bank (CIB) and the international cards and payments businesses.

The Negative Outlook on BBplc's and BBUK's Long-Term IDRs reflects the same downside risks from the pandemic as is the case for Barclays. BBplc's business model is structurally more volatile because of the nature of the bank's businesses and higher reliance on wholesale funding, although the bank has performed well in the pandemic so far, helped by resilient income in the investment bank. Fitch is unlikely to rate Barclays' VR higher than BBplc's because of the latter's significant weight in the group.

The Long-Term IDRs and senior debt ratings of BBplc and BBUK are rated one notch above their respective VRs, and one notch above Barclays' IDR. This reflects our expectation that external senior creditors will benefit from resolution funds ultimately raised by Barclays, which are designed to protect BBplc's and BBUK's senior creditors if the group fails.

The Derivative Counterparty Ratings (DCRs) of BBUK and BBplc are at the same level as their Long-Term IDRs because derivative counterparties in the UK have no definitive preferential status over other senior obligations in a resolution.

The Short-Term IDRs of 'F1' of BBplc and BBUK are the lower of two options mapping to an 'A+' Long-Term IDR as their funding and liquidity scores are not sufficient to achieve a higher Short-Term IDR.

The long- and short-term debt ratings on BBplc's global collateralised medium-term note (GCMTN) programme and notes are at the same level as BBplc's senior unsecured debt because the terms of the notes issued to date do not allow for a one-notch uplift of the rating under Fitch's criteria. The notes are rated under our Bank Rating Criteria, which allow rating of secured senior debt that is not complex.

SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)

Barclays' and BBplc's SRs and SRFs reflect Fitch's view that senior creditors of the bank and the holding company cannot rely on extraordinary support from the sovereign in the event that Barclays or BBplc become non-viable. In our opinion, the UK has implemented legislation and regulations to provide a framework that is likely to require senior creditors to participate in losses for resolving even large banking groups. The SR of BBplc is based on sovereign support because we believe that its role as the non-ring-fenced bank and its size mean that institutional support from Barclays and, indirectly from BBUK, is unlikely.

BBUK's SR of '1' reflects our view of an extremely high probability of institutional support being made available from Barclays and, indirectly, from BBplc, given the ring-fenced bank's strategic role in the group and reputational considerations. Despite its size we believe that support would be manageable.

BARCLAYS BANK IRELAND (BBI), BARCLAYS CAPITAL INC (BCI)

The Long- and Short-Term IDRs of BBI and BCI are equalised with the IDRs of their parent BBplc, which along with their SRs of '1', reflect our view of an extremely high likelihood that BBI and BCI would be supported by BBplc if needed.

BBI houses BBplc's EU operations (mainly CIB, credit cards, private banking and legacy Italian mortgages), with the aim of avoiding business disruption following the UK's departure from the EU. The activities that are housed in BBI give the group uninterrupted access to European clients and financial markets and we therefore view this entity as core to the parent and the wider group's business.

BCI is the broker dealer and futures commission merchant that services BBplc's US-domiciled CIB clients, and a material operating entity of Barclays in the US. Fitch views the businesses conducted out of BCI as core to the group and vital for CIB's client relationships and strategy, which provides a strong incentive for BBplc to support it.

A potential sale of the entities is hard to conceive given BBI's and BCI's business models and high degree of integration with the group, and also because a sale would also alter the group's ability to service international clients. Moreover, potentially allowing these entities to default would give rise to material reputational implications for BBplc, given common business relationships and branding.

Fitch equalises BBI's and BCI's Long-Term IDRs with BBplc's IDR rather than the VR because we expect senior creditors of both entities to benefit from the parent's resolution debt buffers, reflecting regulatory requirements to pre-place junior debt or equity (in the case of BCI, at the level of the US intermediate holding company).

The DCRs are equalised with the respective entities' Long-Term IDRs. The Short-Term IDRs of 'F1' are at the same level as BBplc's.

SUBORDINATED DEBT

Subordinated debt and other hybrid capital issued by Barclays and BBplc are all notched down from their respective VRs, in accordance with Fitch's assessment of each instrument's respective non-performance and relative loss severity risk profiles, which vary considerably.

Barclays' and BBplc's subordinated lower Tier 2 debt is rated two notches below the VRs for loss severity, reflecting below-average recoveries. This includes contingent convertible Tier 2 notes for which we see no incremental non-performance risk. BBplc's legacy Upper Tier 2 instruments are rated lower, at three notches below the VR, due to incremental non-performance risk.

Additional tier 1 instruments and preference shares with no constraints on coupon omission are rated four notches below the relevant VRs. The issues are notched down twice for loss severity, reflecting their deep subordination and poor recoveries as the instruments can be converted into equity or written down well ahead of resolution. In addition, they are notched down twice for high non-performance risk due to fully discretionary coupon omission. The rating of these instruments is supported by our expectation that the group will maintain at least a 100bp buffer over capital requirements that would trigger coupon omission on the bonds.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The most immediate downside rating sensitivity for Barclays and its subsidiaries relates to the pace and extent of the economic recovery following the initial shock from the pandemic. A muted or delayed recovery would likely result in a more permanent damage to the bank's asset quality, earnings and capitalisation than we currently expect, which would be difficult to restore within 18-24 months.

We would likely downgrade Barclays' and subsidiaries' Long-Term IDRs, VRs and debt ratings if the group's CET1 ratio, excluding the IFRS9 transitional relief, looks set to fall towards 12% while asset-quality and profitability challenges arising from the pandemic shock to the economy persist. The ratings would also likely be downgraded if we no longer expect the group's operating profit/RWAs to rise above 1.5% by 2022.

Ratings could also be downgraded if the group increases its risk appetite to boost profitability in the near term. Evidence of this could be a significant increase in RWAs allocated to investment-banking activities or towards higher-risk credit exposures.

BBUK's and BBplc's VRs could be downgraded if the banks' competitive positions or financial profiles weaken and if we believe that ordinary support from the group is not available to offset this weakness. BBUK's ratings may withstand a one-notch downgrade of Barclays' ratings provided that BBUK's financial profile at that point is significantly stronger than that of the rest of the group. The one-notch uplift applied to the IDRs and senior debt ratings of BBplc and BBUK are also sensitive to Barclays maintaining a clear and credible role as the resolution entity for the group.

A downgrade of the UK sovereign rating (AA-/Negative) would result in a downgrade of the operating environment score of BBUK, which is capped by the sovereign rating to the 'a' range. A lower operating environment score would not on its own drive a downgrade of BBUK's ratings but it would reduce BBUK's rating headroom. Barclays' and BBplc's operating environment scores and ratings are less sensitive to a UK sovereign downgrade given their geographic diversification.

BBplc's DCR is primarily sensitive to changes in the bank's Long-Term IDR.

The ratings of BCI and BBI could be downgraded if BBplc is downgraded or if they are no longer expected to be protected by resolution plan buffers of junior debt/equity from BBplc.

The Short-Term IDRs could be downgraded if Long-Term IDRs are downgraded to 'A-' and our assessment of funding & liquidity falls to 'a-' or below.

The ratings of AT1s could be downgraded if we see a heightened risk that capital cushions above maximum distributable amount (MDA) trigger points will fall below 100bp.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The Outlook could be revised to Stable and the ratings affirmed if sharp deterioration in credit losses beyond our current expectations becomes less likely and if the group's revenues and capitalisation continue to demonstrate resilience in a challenging environment.

In the event Barclays is able to withstand rating pressure arising from the pandemic, an upgrade would require a sustained improvement in earnings through the cycle, resulting in a materially stronger capacity to generate capital internally, which we do not expect in the near term. Barclays' IDR could be rated above the VR if AT1 and Tier 2 debt increase sustainably above 10% of RWAs, but we view this as unlikely.

The Short-Term IDRs of Barclays, BBplc and BBUK could be upgraded if our assessment of their respective funding & liquidity improves to 'aa-' or above. Short-Term IDRs of BBI and BCI could be upgraded if BBplc's Short-Term IDR is upgraded.

## Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## Public Ratings with Credit Linkage to other ratings

The IDRs of BBI and BCI are based on BBplc's.

## ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Barclays Bank UK PLC; Long Term Issuer Default Rating; Affirmed; A+; Rating Outlook Negative
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a
; Support Rating; Affirmed; 1
; Derivative Counterparty Rating; Affirmed; A+(dcr)
----senior unsecured; Long Term Rating; Affirmed; A+
----senior unsecured; Short Term Rating; Affirmed; F1
Barclays plc; Long Term Issuer Default Rating; Affirmed; A; Rating Outlook Negative
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a; Rating Watch Off
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----senior unsecured; Long Term Rating; Affirmed; A; Rating Watch Off
----subordinated; Long Term Rating; Affirmed; BBB-; Rating Watch Off
----subordinated; Long Term Rating; Affirmed; BBB+; Rating Watch Off
----senior unsecured; Short Term Rating; Affirmed; F1
Barclays Bank plc; Long Term Issuer Default Rating; Affirmed; A+; Rating Outlook Negative
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a; Rating Watch Off
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
; Derivative Counterparty Rating; Affirmed; A+(dcr); Rating Watch Off
----senior unsecured; Long Term Rating; Affirmed; A+; Rating Watch Off
----subordinated; Long Term Rating; Affirmed; BBB; Rating Watch Off
----subordinated; Long Term Rating; Affirmed; BBB+; Rating Watch Off
----subordinated; Long Term Rating; Affirmed; BBB-; Rating Watch Off
----senior secured; Long Term Rating; Affirmed; A+; Rating Watch Off
----senior unsecured; Short Term Rating; Affirmed; F1
----senior secured; Short Term Rating; Affirmed; F1
Barclays Capital Inc.; Long Term Issuer Default Rating; Affirmed; A+; Rating Outlook Negative
; Short Term Issuer Default Rating; Affirmed; F1
; Support Rating; Affirmed; 1
; Derivative Counterparty Rating; Affirmed; A+(dcr); Rating Watch Off
Barclays Bank Ireland Plc; Long Term Issuer Default Rating; Affirmed; A+; Rating Outlook Negative
; Short Term Issuer Default Rating; Affirmed; F1
; Support Rating; Affirmed; 1
; Derivative Counterparty Rating; Affirmed; A+(dcr); Rating Watch Off

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Additional information is available on www.fitchratings.com

**Applicable Criteria**
Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)
Non-Bank Financial Institutions Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

**Additional Disclosures**
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Status
Endorsement Policy

rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

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