

**Barclays PLC HY 2021 Results**

28 July 2021

**Fixed Income Results Call Q&A Transcript (amended in places to improve readability)****Lee Street, Citigroup**

I have two questions. Firstly, you've got a lot of excess capital, and you've got quite a big on balance sheet provision still even after your reversal today. My question is, what keeps you awake at night? What can go wrong from here, because obviously everything looks like it's relatively well set?

Secondly, you touched on the legacy securities and said that you could leave them outstanding beyond the year-end. As it relates to LIBOR, what's the regulatory and the FCA's expectations there? Is it sufficient that you've offered people a consent? If they choose not to accept it, [would the regulators acknowledge] that you've done everything within your control to address that, and therefore they'll not have an issue leaving that outstanding?

**Tushar Morzaria, Group Finance Director**

Why don't I have a go at your first question, and then I'll ask Kathryn to cover your question on LIBOR. What keeps us awake at night? I think I agree with you that we feel our capital position is reasonably prudent, and we think our provisioning levels are also reasonably prudent. I think the real unknown is we've got government support schemes that are being unwound. It's the first time we're going to experience what the real-life consequences of that are, both here in the UK and to some extent in the US, [where] unemployment benefit and extensions [are coming] to an end, as well as some of the support schemes around SMEs and corporates.

Hence the level of provision that we're carrying, and we have a management overlay to ensure that we are prudently provided against that, but I guess that's a little bit of a voyage to the unknown. We don't exactly know how that will work out - it could be a much more orderly adjustment than people anticipated; it could be a bit rockier. Albeit economies are opening up and case loads seem to be dropping, at least in the UK, there's still a little bit of unknown as to whether this is the end and the final wave, or whether things may change again as you're getting to the winter months.

So it's just being a little bit cautious and prudent, but no more than that. I think until we're through all of that and we're back to, if you like, a proper post-pandemic environment, we'll probably run everything a little bit prudently.

**Kathryn McLeland, Group Treasurer**

I think the only other subject that everyone has read about is the prospect of inflation at some point, and obviously the uncertainty that Tushar talked about in terms of government support schemes. There's a degree of discussion around central bank policy response, tapering QE, hiking rates. Whilst it might be a

lower probability risk, [we are being mindful] just thinking around the balance sheet and the prospects of inflation. Albeit certainly this is not a base case, but that's obviously had a fair degree of commentary [in the market], so I think that's the only other thing I'd mention.

**Lee Street, Citigroup**

On the topic of inflation, and I'm jumping a little way ahead, how many rate hikes do you think we could possibly see before it actually started to really bite in some of the credit quality? Obviously historically rate hikes do impact credit quality, [but] I'm presuming the first couple will probably not have that much impact and actually supports you from a margin perspective, so is there any indication of what would be the biting point that would start to worry you?

**Tushar Morzaria, Group Finance Director**

Yes, it's a tricky one. We would probably need something like three hikes before we get back to base rates in the UK pre-pandemic, and even then you'd be 75 basis points or so, so my sense is that it will take some time. In the environment of rate hikes, if it's purely anti-inflationary and a stagnating economy, that's obviously a bit more credit problematic. If it's on the back of an economy that's growing above trend and just good monetary policy in the backdrop of that, that's probably not so much of a problem.

As Kathryn says, it's a remote possibility that you get an unravel in the inflation. That could be difficult, but we'd probably put that in the low probability camp. It's probably less of the ones that keep us awake at night. It's just one of the things we've got in the back of our minds to make sure we don't get caught out by if it does happen. But I think it'll be a number of rate hikes before we really, really feel we'd want to reconsider our credit stance.

**Kathryn McLeland, Group Treasurer**

[To answer] your question on LIBOR, what we've been doing is a huge amount of work happening internally. Very mindful of what's happening with the official sector news externally, and Q2 saw us starting to actively track new LIBOR products much more clearly, obviously very mindful of what's allowed there.

We saw the development from the Fed with the legislative change regarding dollar securities, but in terms of the UK regulator, in terms of any existing LIBOR securities that we have after the consent solicitation that we did at the end of last year, we're essentially still waiting for some guidance and the final outcome around the definition of tough legacy and what that means for synthetic LIBOR. Of course, as you know, there are ultimately fall back provisions as well, so we're essentially in a wait and see mode, waiting for further guidance around that tough legacy.

**Paul Fenner, Société Générale**

[I have] an asset quality question, but it subdivides into a couple of separate questions. If I look at your stage migration, it looks as if the portfolio is really behaving extremely well and probably counterintuitively. Nominal stage three has dropped quite a significant amount in the last six months, and the ratio is now 2.2%, having come down fairly consistently over the last couple of quarters.

My question is on stage three, have we seen the peak as a proportion of your book? If we haven't, when do you think that peak is and how far away are we? I'm not looking for a specific ratio, but just a tan line just to get a sense. I get asked that question all the time and I can never really answer it very well.

On stage two, I would also like to know what normal looks like. Right now you've got something like 11% or 12% of your portfolio in stage three, which is down as well. What does normal look like as you look into the end of 2021/22? I forget what it looked like pre-crisis, so I'd love to get a sense.

The other thing I found quite interesting is that the drop in stage two was just as big in retail as it was in corporate. I thought it was corporate that was the most sensitive to your macro outlook, so a little bit of colour around that would be very helpful.

And then the very last question is on supply. I think you said that the remaining £2.5-3bn is going to be between AT1 and Senior HoldCo. I just wanted to check that I heard you right, because I was expecting you to do an AT1 and it hasn't happened yet?

**Tushar Morzaria, Group Finance Director**

[On] the first part of your question [around] the peak in or the development of stage three balances - when is the peak going to happen, has it already happened, where could it settle down. The honest answer is we don't know.

Having said that, our view is that the management overlay that we're carrying is really there to guard against an increase in defaults as we go through the removal of government support schemes. These are all estimates and we've done our own modelling, but of course there's no historical precedent we can calibrate our models or anything to, so there is definitely a high degree of judgement here.

But our view is that there ought to be a pick up in defaults and credit stress within the level of provision that we're carrying, and that's what that overlay is specifically designed for. If we don't see that, if it's a very orderly adjustment and the government support schemes have worked perfectly, in the sense that they've bridged everybody to their job or the company reopening again and it can sustain itself, then obviously that management overlay won't need to be digested against defaults and will just be released through P&L and ultimately back into capital.

We would expect the peak in stage three to be in front of us, but not that far in front of us. I think both sides of the Atlantic now are beginning to taper their schemes over the next handful of quarters. In terms of the run rate on stage three from that point on, if you look at the loan loss rate on the more riskier parts of our business, say credit cards, we're roughly about 3% loan loss rate on either side of the Atlantic.

I'd probably say the books ought to be probably a bit higher quality compared to pre-pandemic. Obviously that was quite a long cycle, and one of the things about having a cycle is you flush out the weaker credits one way or the other. Generally speaking, those remaining consumers will be in decent financial positions.

You see our deposits ticked up again, quite materially even in the second quarter in our consumer [books], both in the US and in the UK. So the deleveraging of consumers and the amount of cash on balance sheets will be very supportive. Also as we're originating, you're early in a credit cycle, so your originations ought to be relatively lower risk. I would say all things being equal, you should probably have a lower loan loss rate on the riskier parts of our book once we're, if you like, in a proper post-pandemic world.

There's a couple of questions there about the sensitivity to macro across corporate and consumer, and also what's the normal level of stage two. It's quite hard to answer that question precisely in the way you indicated yourself. What I'd probably say though, if you look at our cards business [and coverage levels pre-pandemic], we were 8.1% loan loss provisions to balance sheet, and we're currently over 10%, so we're still quite prudently covered relative to pre-pandemic levels.

When it's all said and done - we've gone through the government support schemes, things have normalised out, and we accept the premise that the books ought to be, on a like-for-like basis, of better quality, you'd probably expect the coverage levels to be at least back to pre-pandemic levels or if not a touch lower. Now they'll either be effectively utilising those provisions against defaults as we're expecting them or those provisions will be released into P&L.

So it doesn't quite answer your question about stage two. It's a combination of stage one and two principally, but hopefully it gives you a sense of it probably ought to be a bit lower than pre-pandemic, all other things being equal. In terms of the macro sensitivity, that's really tricky because these models are devilishly complicated. The reason why it's complicated is you've got multiple scenarios, and you've got various different parameters that impact consumers and wholesale credits in quite different ways.

Workforce engagement, for example, impacts wholesale in a way that's slightly different to general population. Unemployment impacts our models for consumer, so it's hard for me to give you a straight answer on that. It depends on the scenario weightings, the span of scenarios, and exactly how far out the peaks and troughs are. It's unfortunately not an easy answer to give, but I hope it gives you a little bit of context anyway.

**Kathryn McLeland, Group Treasurer**

To answer your question on funding, our needs haven't changed at all since the full year and you're right, we've done just over £5bn, almost £5.5bn in the first half, and we have done two benchmark Tier 2 transactions. So in the second half of the year, [the remainder of] the c.£8bn will most likely be in the form of Senior and AT1. It's exactly the same as what we indicated earlier in the year. As you know, we've also talked in the past about being a programmatic issuer of AT1 securities, so that does remain part of the funding plan for the second half of the year.

**Robert Smalley, UBS**

I appreciate the intricacy of model changes, particularly given the peculiarity of this economic environment, but maybe you could talk a little bit about differences in UK vs. US credit cards? So far they numerically performed roughly the same way, do you see any divergence there and anything that you would look at differently behaviour-wise in your modelling?

Secondly, you had mentioned the possibility of going below pre-pandemic level on reserves, but I guess from your comments that'll take a few quarters at least to get there. You're pretty close on cards already, so would that come from SMEs and other corporate lending? Where would you see that? Given the headwinds that you outlined for capital, is there an impetus to do that sooner than later, even though you had also mentioned you wanted to be prudent holding your reserve?

Finally on funding, it may be early days, but you're a negative issuer in 2021. Do you have any visibility to 2022? Do you think you'd also be a negative issuer then?

**Tushar Morzaria, Group Finance Director**

Why don't I tackle the questions on provisioning and hand over to Kathryn on funding. On US and UK cards, yes they have behaved remarkably similarly, but I would expect a divergence prospectively. I think we would expect to see a build in US revolving credit cards balances sooner in the US than in the UK. I think there's a couple of reasons for that.

One is just that the US economy has opened up earlier than the UK, so it's further ahead in its recovery and you're into a period of time - summer vacation, back to school, Thanksgiving, Christmas - where you get more discretionary spend behaviour, and that tends to stimulate revolving credit balance growth.

Specifically to our business, we'll be adding the American Retirees (AARP) card partnership in the third quarter, and we've got one well-known retailer that we're adding into next year alongside organic growth. So I think you'll see balance and therefore provision build much sooner in US cards than UK cards.

Our sense is, even though it's both sides of the Atlantic are spending back to pre-pandemic levels, at least on our data, the level of discretionary spend that's taking place on cards will take some time before it translates into balance growth. So yes, I think you will see a divergence, and that'll simply just be where they each are in their own cycles with respect to recovery.

The final thing I would say on UK and US cards is in US cards we're certainly adding more customers, and we're spending money on opening new accounts, stimulating card spend. The FICO Scores in the US, again, it's relatively high quality stuff. Part of it is just because we're biased towards airlines and things like that in our portfolio. It's arguably at the lower end of the margin, but also at the lower end of risk with respect to the US cards business.

In terms of provisioning levels and getting back to pre-pandemic or better, I think actually we're not so far away from cards, but the bulk of our provisions are actually from the cards business. It's a disproportionate amount. Coverage levels pre and post on an average basis, I think on cards we're still over 10% covered, and pre-pandemic we were just about 8%. That's like a 20% reduction in coverage, so that's a big old number, given that most of our provisions are against cards balances.

There is some in corporate and SME. Not so much actually, it's relatively small. Most of the lending in SME tends to be secured. In corporate credit, there are some vulnerable sectors, but in terms of the pace at which these things, if you like, normalise away, I think it's a number of quarters. It's very difficult to put a time on it, but I think our approach has been to build reserves quickly, and to release them quite slowly until we're absolutely certain that the necessity for holding those provisions is behind us.

We will be pretty cautious in releasing them, and I would say even after today's release our coverage levels are materially above where they were pre-pandemic. [According to] the credit indicators that we have in front of us, there's no real signs of stress in our books as we see it, so we will continue to be quite cautious.

#### **Kathryn McLeland, Group Treasurer**

In terms of issuance vs. redemptions, as you said, this year was a net £1bn. On the redemption side, that was supported by a meaningful amount coming from our OpCo. It is, as you know, too early for us to guide on issuance for next year, but I'll hand over to Dan who can talk a little bit more about the funding profile that we have.

#### **Dan Fairclough, Group Head of Balance Sheet Management**

Yes, so next year we've got about £10bn of maturities and calls across B and BB PLC, so quite a significant redemption for us. Again, that's a little bit higher than the £9bn that we had this year. If you take out the average run rate of issuance in historic years, which has been £8-10bn, then I think there's a decent chance that we would continue to be a net negative issuer. But, as Kathryn said, we'll update more at the full year on the issuance plan.

**Daniel David, Autonomous**

I've just got a couple on legacy - the comments that you opened with and the mitigations that you mentioned on infection risk. In the recent AT1 monitoring report, the EBA raised concerns over a multi-layered Tier 2 structure, and they were referring to cascading Tier 1s, which I think is applicable to the way that you're planning to treat your Tier 1s. They mentioned concerns about No Creditor Worse Off [principle] and BRRD, is that something you're thinking about? Is that a concern that we should be thinking about with your legacy stack?

On ESG, in the recent MREL Consultation Paper, I noted there was a comment that firms may wish to structure their MREL instruments to include ESG-linked features. I thought that was quite interesting. I'm just interested to hear your take on whether that could mean we see a different type of ESG issuance, maybe linked to other ESG targets?

**Dan Fairclough, Group Head of Balance Sheet Management**

To some extent, the multi-layered Tier 2 arguably already exists today with the old upper Tier 2 and the lower Tier 2, so it's not something we're hugely concerned about. I think for us the key point on the infection risk is the fact that we will want qualifying AT1 securities to be the most junior form of instrument outstanding, and we think that's going to be the key point for the Bank of England. As Kathryn alluded to in the speech, that's a relatively easy thing for us to achieve just by amending the subordination language for that downstream AT1, so overall we don't think that's a huge risk in terms of the Bank of England.

**Kathryn McLeland, Group Treasurer**

In terms of the question around green MREL, yes we did see that in the CP, and certainly you heard this afternoon that we've updated our green bond framework. What we've done is align it to our sustainable finance framework, which covers all the Group's plans to hit our quite ambitious target. We have net zero and really focusing very much on the asset side, so now we have our liability funding programmes linked to the asset side and have the flexibility now to issue different forms of liabilities. We can do CPs, structured notes, and covered bonds.

I do think that there will probably be some innovation in this area, as obviously we have COP26 coming up and UK banks look at their own ambitions on the green agenda, and perhaps some interesting developments in the green space. Obviously we've also seen securities amongst our international peers link to other ESG criteria and targets the banks have, so there could be some interesting developments in this space.

I would just caution a little bit that many banks are very well-funded and we've talked about the very liquid balance sheets for deposits, and we're very well advanced on MREL plans, so it will be obviously within the overall funding needs of the UK banking sector.

**Jakub Lichwa, Goldman Sachs**

Can I just go back to the comment about the impediment to resolvability and how you are actually seeing that? I just didn't catch that in the context of the legacy securities being issued out of the operating company.

**Dan Fairclough, Group Head of Balance Sheet Management**

There are two aspects to consider here. The first one is infection risk, so have we got a structure that contaminates regulatory capital eligibility? And the point that I was making there is that as long as our

internal AT1 is the most junior form of capital at the operating company, which can be achieved through a simple internal restructure, we don't think that is an impediment in any way. The second group is obviously the outstanding legacy securities that we have, and as Kathryn said in the main speech, we've got a very short tail of those securities and we have none of those legacy securities issued at B PLC, so we feel generally in a good place.

**Jakub Lichwa, Goldman Sachs**

Are you implying that having a small stock of securities at the OpCo level is not actually an impediment to resolvability? I understand the point about infection risk and restructuring internal agreement. It's just more on the second point, how is the fact that they are in the OpCo is actually being addressed?

**Dan Fairclough, Group Head of Balance Sheet Management**

From our perspective, these securities become particularly problematic when they lose regulatory capital eligibility. We've got a very small number outstanding and they retain capital eligibility significantly through the transition profile, so we actually think that the problem here is extremely modest. Obviously we've completed our submission to the Bank of England on that, and ultimately we'll hear more and you'll hear more from them when they publish their resolvability assessment, but from our perspective we really do think this is a relatively small issue.

**James Hyde, PGIM**

I have one question on the whole revenue outlook. You've given cost guidance, you've given provisions guidance, but on revenues, a lot of the guidance on this morning's call was about NIM and BUK and also the card volumes. But I just got the feeling, looking at both the slides and what's happened in capital markets, that it looks like you're saying the whole capital markets piece is as good as it gets for you guys.

And when you've got a Group RoTE of 16% and you've promised 10%, to me it reads that from here the only way for the CIB is down. Am I misinterpreting that? You've had obviously these 4-5 years of idiosyncratic market share gains. Should we read that as over for you? That's the first question, and the second one is the old chestnut of Basel III final stage, Basel IV, any fuel for guidance?

**Tushar Morzaria, Group Finance Director**

Why don't I cover the outlook for income and I'll hand over to Kathryn to talk a bit more about Basel IV. In terms of CIB, I'm not sure we've seen the best of it yet. I think there is some potential there. I think in capital markets and advisory, so I'm talking here debt capital markets, equity capital markets, M&A, the old pipeline is actually higher than it was in Q1. Markets are still pretty constructive, and there's a lot of money looking to find assets.

So I think there is definitely scope for that to be a very good environment, and we'll see how well we do with that. We've made great progress. We've been a very strong debt house over a number of years, but our ECM and M&A practice both have had terrific quarters for where we are at least, so I think that's probably still a very constructive environment.

I think on the sales and trading side, equities, again, we've done pretty well. We had record prime balances at the end of the second quarter. Those are very stable repeatable revenues, depending on obviously where financing spreads are, and you get the halo effect of more execution business as you prime more clients. So the equity story for us is quite good, and on the fixed income side, that's definitely suffered from the dizzy heights of last year.

We had a question earlier [around] is there going to be an inflation shock and things like that. Those kinds of things can all of a sudden catalyse sales and trading to bursts of activity that are way above normal expected levels. Albeit I think it's a fair comment to say how can the industry continue to post record quarter after record quarter. I think that's absolutely a fair point and that's unlikely to happen. I also don't necessarily see that there couldn't be very strong quarters in the future or indeed even new records posted, and you may get intermittent spells of heightened volatility, so we are pretty constructive on the CIB topline.

Jes Staley, our CEO, always makes the point that if you look at the world of just financial assets, and the absolute explosive growth in financial assets over the last number of years and be an intermediary in, whether it's a secondary or primary market, on a secular basis is a good place to be. Now, there'll be ups and downs within the micro cycles, but we believe that there's a very strong secular case to be made in that business.

**Kathryn McLeland, Group Treasurer**

I think you've seen that we've given quite detailed guidance around some of the near and medium-term capital headwinds, [including] the software intangibles, SA-CCR, IFRS 9, and pension contributions. We do always know that it's helpful to provide guidance to the market around some of these regulatory impacts that are coming down the pipe, but just at the moment, it probably would not be helpful. It's a little bit too early.

As you know, the PRA certainly needs to consider their own timetable for implementation, their approach to some of the different components of the rules, and the implementation is also out to potentially 2028 once you think about the phasing of some of these changes. Certainly when there's a little bit more clarity, we will absolutely try to provide you with guidance around these impacts, but it's still a little bit too early.



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