30 October 2014

Barclays PLC

Barclays PLC Q3 2014 Interim Management Statement

Analyst call Q&A transcript (amended in places to improve readability only)

Raul Sinha, JP Morgan

Hi, morning Tushar. I'll limit myself to two then, I had three. The first one is on the Lehman Reserve. Clearly this is the second time you've taken a write back on that. Can I ask how much is left now, and how do you actually expect the case to evolve going forward? Is this something now that goes quiet for a while, or is there potential for more to come back to Barclays around this area?

Tushar Morzaria

You may recall that we had a $1.6 billion effective provision in our balance sheet for the Lehman receivable. We've released part of that, Raul. We've released part of that this quarter, so the remaining receivable in dollars is a further $850 million. Where do we go from here? This has been running on for a number of years, this court case, and the reason why we released part of that receivable provision this quarter was as a direct consequence of the cases that came to appeal, and were adjudicated in our favour, I think twice over the quarter. And we've also received cash payments in relation to some of these assets as well. So that allows us to be in a position to release part of the receivable. We'll see how the remaining legal process goes from here, and whether we're in a position to release further receivables, and that's unclear at this stage.

Raul Sinha

Is there a timeline on this?

Tushar Morzaria

You can imagine with legal things, this thing's been running on for six years, so I'd like to think it doesn't take another six years, but I can't give you, unfortunately, anything more specific than that, legal cases seem to have a timeline of their own, unfortunately.

Raul Sinha

Great, thanks. And then can I, secondly, just ask you maybe to share your thoughts on the leverage ratio announcements tomorrow. Maybe before you tell us where you expect it to be, if you want to tell us that, maybe could you talk about where do you think Barclays can actually operate in the long term on the leverage target? And do you think, are you comfortable to operate the bank at 5%, let's say, if you were required to by the FPC?

Tushar Morzaria

Yes, we'll all see the paper from the PRA tomorrow, so I'm not sure there's any point in any of us speculating what we'll learn about tomorrow. But, you know, leverage for us, we've made quite significant progress over the last 12 months. We guided to being at 3% at the halfway point in 2014 on the PRA measure. We got to that by the beginning of the year. We'd guided to 3.5% on the BCBS measure by the end of next year, we've got to that at least a year early. And if you look at the leverage exposure reduction that we've had over the last 12 months or so, it's a little bit apples and oranges because we switched from the PRA leverage exposure measure to BCBS. But you could probably estimate on a BCBS measure, the full scale reduction somewhere around £250 billion. And that's with the significant losses that we've encumbered.

So I think we've got very good momentum, very good progress in reducing our leverage exposure, and we've got a good plan to get after this. You also know, as you've seen, we've guided to wanting to run the company at greater than 4%, and that's absolutely our firm intention, and feel very comfortable being able to do that. If leverage requirements are higher than that even, let's say greater than 5%, I think it really boils down to timing. I think over a reasonable timeframe that's entirely achievable for us, and we'll see how that is tomorrow. But leverage is, I think, a reasonable story of progression for us, and I think we have very good momentum.

Raul Sinha

Right, thanks very much.

Tushar Morzaria

Let's move to Chintan.

Chintan Joshi, Nomura

Hi, good morning, Tushar. Two for me, first on investment banking, just following the conversation we were just having. When you did the strategic update, I suspect you had something like a 4.5% leverage ratio in your planning. You have mentioned you will optimise costs and capital to achieve profitability in this division. Say we get a 5%, or even a higher leverage ratio tomorrow, is it fair to assume then that you'll have to rethink the size of the Investment Bank to help to get you to your leverage ratio? That's the first, and then one on FX.

You've taken half a billion on FX litigation, is this your first stab at a probability adjusted model based estimate, or is this what you think you will end up paying?

Tushar Morzaria

All right. Thanks Chintan, let me take them in the order you gave them. So, again, I guess the heart of your question is, what happens if there's a 5% leverage ratio announced tomorrow, and what implication would that have to our Investment Bank? Again, I don't want to speculate what may or may not be announced tomorrow. I would say though, when you look at leverage ratios for the Group - you probably won't be able to see this from the numbers, but it sort of helps you guys out - if you look at our Core businesses, we're actually already operating close to a 4% leverage ratio in the Core businesses. They obviously have a higher leverage ratio than in the Non-Core businesses, but you've seen we've taken out more than £60 odd billion pounds of leverage in the Non-Core, just in this quarter. And we'll be hitting our £300 billion milestone that we indicated to.

So I think when I look at the balance of the Group, you can see the Core Group already operating at more reasonable leverage ratios, and the balance of reduction coming out of Non-Core, and we've got really good momentum in there. Within that, of course, it includes the Core Investment Bank, and I think that's a reasonable position to be in.

Regarding the foreign exchange, I think probably many of you will want to know a bit more about this, but, unfortunately, it's not a lot I'm going to be able to say. I'll just go back to the very careful words that we chose. We're in live dialogue with a number of the regulatory agencies, and for those that we're in live dialogue with, this £500 million pound provision is our best estimate of the provision that we should be taking. These are fluid discussions, and we'll see how that evolves. But that's our best estimate today.

Chintan Joshi

All right, thanks. Just quickly, when you did your strategic update, what leverage ratio were you assuming for Core?

Tushar Morzaria

As you know we've guided to greater than 4% for the Group as a whole, and we expect to have a relatively small Non-Core unit by the time we get there. So, that should give you a good sense of how we were thinking the Core would play out.

Tushar Morzaria

Okay. We've got Michael, from Bank of America.

Michael Helsby, Bank of America Merrill Lynch

Yes. Morning everyone, just a couple from me then. So, first on the non-IB revenue, really solid performance in PCB revenue, up 2% quarter on quarter. It does feel like the trends are different in retail and corporate though. So if you could give us a bit more commentary on the revenue trends in those businesses, and if you can break out a bit more granularity going forward, that would be really, really helpful. And just attached to that, equally good performance in Barclaycard, revenues up 4% quarter on quarter. How much of this is FX going back in your favour in Q3 versus the underlying revenue growth?

And, question two, thanks for your comments on the Investment Bank in Equities, the IBD was really poor as well, quarter on quarter, and actually I think stood out relative to the industry. Was that impacted by all the dark pool stuff as well? And if you could extend your comments to how that pipeline and mandate has progressed through the quarter, and into the outlook, that'd be very kind. Thank you.

Tushar Morzaria

Yes, thanks, Michael. Just talking about, going to your first question, I'll take them in the order you gave them; non-IB revenues, the mix in Personal and Corporate Banking. Really the positives in this quarter were very much in our residential mortgages and personal savings products where we continue to improve and increase our stock of mortgage market share. We've been growing that stock larger than the market's growing, I think I said 23 out of 24 quarters and that's been a very good business for us. Our savings product has also seen good returns there as well. In fact, what I would say is across our retail businesses, current account balances have grown steadily, and we think they're probably growing quicker than the market, savings growing nicely, and we're seeing nice margin expansion from there. Mortgages I've talked about.

On the corporate side, we have seen some softness in fees, really from cash management, mostly related to foreign exchange. And we're seeing a little bit of compression in liability balances. But overall, again, when I look at our corporate lending business that's growing a little bit quicker than we see the market, at least the market that we're operating in, and I look at our SME lending, again that's doing very well relative to the market, those markets going a little bit quicker than we see the market we're operating in. So, I think the mix is quite nice and well balanced, but, probably retail driving the numbers at the moment relative to corporate.

Card, you're right we did have a little bit of tailwind from foreign exchange. I actually don't have the breakout for you on the quarter. Obviously for the full year, it's actually a headwind over the first nine months, and, you know, income was up 6% over that period including that headwind. We could get that breakout for you. But it's a nice steady improvement coming from growing balances there.

Investment banking division and the weakness there, I think there's two things going on. There's a little bit of a calendar effect, so we did have a strong second quarter in investment banking fees. We're not going to be able to run at those kind of levels every single quarter, you've seen a little bit of a calendar effect in terms of deal closing timetables, and we did see some M&A transactions push into the fourth quarter from the third quarter. And that impacted it as well. I did talk about DCM being a little bit weaker than we anticipated, mostly from leverage finance where we decided not to participate in certain transactions that were beyond regulatory guidelines.

In terms of when I look at the investment banking division, I look at our UK market share, I see share that's a little bit higher than it was last year, in fact. So we've improved our market share there, and we're a good number two. In the US we were fifth, we dropped a place to sixth in fee share. You know, four, five, six and seven tend to be very tightly bunched, so I think you'll see a little bit of jostling of places for there in any one quarter. But by and large, that business is actually holding up pretty well. I think you're seeing more of a calendar effect, and a little bit of pull back from LevFin for us.

Michael Helsby

So, while you can clearly see equity clients leaving you from the dark pool perspective and then coming back, you didn't lose any advisory mandates, or see any obvious linkage from that dark pool allegation?

Tushar Morzaria

Not in capital markets, no.

Chris Manners, Morgan Stanley

Good morning, Tushar. So two questions, if I may. The first one is you mentioned in your reports 16.1p of adjusted EPS for the nine months, and I'm assuming you hopefully won't make a loss in the fourth quarter. And so, with your 40% pay-out ratio minimum, that would indicate to me that you're going to actually increase the dividend this year, from just applying 40% to a number greater than 16.1, to get higher than 6.5p. And given your focus on capital build I was just trying to work out how I marry up that pay-out ratio commitment and raising the dividend with building the capital ratio.

Second question, just echoing Michael's request there, was whether we could have a bit more divisional disclosure on the retail versus corporate in the UK. Obviously two very big blocks, they're bigger than Africa each, and so it would be very helpful if we could see how they're trending. And I saw that obviously you're making good progress on the retail side, but you actually have loans down, deposits down in that overall. Just trying to work out what was going on there? And you have the net interest margin up 12 basis points quarter on quarter, and how sustainable is that? Thanks.

Tushar Morzaria

So taking the questions in order you gave them. Firstly on how we're thinking about dividends. I mean, Chris, there's really no new news there. You know, our philosophy is to continue to try and be a good dividend payer, and we've guided to a 40% payout on adjusted EPS. There's really no changing guidance there. Obviously, dividend decisions for the full year, I can't comment on now, and that's a matter for the board. But really, no change in guidance there.

In terms of your subsidiary point though, capital build versus distribution, we are very focused on capital accretion, and if you look at this year, taking into account Spain, just so that we look at the full bookend, we started the year at 9.1%, on the CET1, and we'd be at 10.4% including the sale of Spain. And as you'll know, that's after accruing for our 40% payout in dividend per regulatory capital rules. So, we feel pretty good about the capital accretion that we've had this year, as well as, in the context of some of the provisions that we've taken for legacy conduct issues as well.

In terms of echoing Michael's request for more disclosure on corporate UK. Point taken, we'll have a think about that, but understand why that would be of interest to you, and appreciate that. In terms of where we go on NIM, the NIM expansion that you saw this quarter really came from mortgages and savings, probably more from savings really. On the corporate side we have seen cash balances and assets decrease slightly, but not in an area that actually worries me too much. As I say, when I look at where we are for that market, the underlying trends are actually pretty good. I think we're in a very good place. I don't think you'd expect to see that NIM expansion. I think it will be broadly stable, I don't think you'll see it continuing at this sort of trend prospectively. Time will tell, but I think it will remain broadly stable.

Chris Manners

Perfect. Thank you very much, that was very helpful.

Tushar Morzaria

Thanks, Chris. Joseph from Jefferies.

Joseph Dickerson, Jefferies

Hi, good morning. Thank you for taking my question. First question; you mentioned that you expected a more normal Q4 in Equities. Can you indicate whether or not this has been the case Q4 to date i.e. the month of October? And secondly to ask Chris' question again on the capital build versus pay-out: it looks like you'll be delivering your 10.5% CET1 target early, clearly by the end of this year pro-forma for Spain. So, you've indicated that you wouldn't be increasing your payout ratio until you cross that Rubicon Do you think there would be scope to increase to the higher end of your pay-out ratio next year as you go into the 11% range? Thanks.

Tushar Morzaria

Yes, thanks, Joseph. Just taking your questions in the order you gave them. Where are we in Q4 for Equities? I think we'll get back to normal run rates over the course of the quarter. I wouldn't say we're there yet. Having said that, October's a slightly tricky month to look through, because obviously we had a lot of volatility part way through [the quarter] with very large movements, particularly in the Fixed Income markets. So it just makes it a little bit trickier to look through. But I think as we go through the quarter we'll get closer to normal run rates, but I wouldn't say we're there yet.

In terms of capital build versus payout, you're right in the sense we guided to a 40% payout ratio until we get to 10.5%, and then we'll review it again then. I think we'll make the same deliberations where we'll look to see the relative balance between capital accretion and distribution. But we'll make that assessment as and when we get to 10.5%. I would continue to guide you to the lower end of the payout ratio for now.

Joseph Dickerson

Thank you.

Tushar Morzaria

Let's move onto the next question. Martin, from Goldman.

Martin Leitgeb, Goldman Sachs

Yes, good morning. My first question is with regards to your equity revenues in the Investment Bank, and obviously the revenues there were down £234 million in the quarter. And I was just wondering if you could help us size this a bit more within sub-divisions of Equities; how much of that £234 million decline is attributable to the dark pool itself, and how much of the residual decline is caused, or was driven by cash equities, prime brokerage or derivatives?

And the second question is with regard to your US asset reduction. Just looking at your balance sheet for Barclays Capital Inc as of end of June, which was just recently published, it doesn't seem like that there was a material decline yet in total assets. Could you guide us when we could expect to see some of the asset reduction, probably repos, to commence? Is that going to be closer to when the IHC rules are introduced in the US? Thank you.

Tushar Morzaria

Yes, thanks, Martin. I tend to look at year on year performance for Equities rather than linked quarters. There's usually a fairly pronounced reduction from Q2 to Q3 in Equities, at least for our business because the dividend season tends to be clustered around Q2, and that tends to be the best quarter of the year typically. Having said that, your point's still a good point, which is even if you look at year on year, there is a meaningful decline in revenues from, say, 524 down to 395. How much of that was from dark pool? Look it's very hard to be precise around these things. But we had good, strong momentum in the first half of the year, so I think in my mind I would put the bulk of the reduction year on year probably driven by dark pools.

It wasn't just in cash. The LX pool itself is very directly impacted, and it's very easy to measure, but as you know the commissions from the LX pool, in and of itself, aren't that material. But the broader impact to our US cash equities financing, and for that matter derivatives franchise, did get impacted. I'd say, probably the majority of the impact was coming from there, but as I say, clients have come back, volumes are increasing, and we are getting back closer to normal run rates. And clients have been very good with us, they've been very constructive, and we've had very positive dialogues with many of them. So we feel pretty good about that.

In terms of US balance sheet and asset reduction, as you'll be more than familiar, we'll be submitting our IHC plans to the Fed in January of next year, beginning of January. That will clearly lay out with our regulators what our balance sheet plans are to ensure that we're compliant with all of the local regulations that are required of us. It's premature for me, until we've had that dialogue with the regulators, to be talking very openly about that - just respectful of that dialogue that we're having with them first. But you should expect to hear from us over the course of next year in a bit more detail of what our plans are. But, in summary, Martin, in terms of meeting leverage requirements, whether it's local to the US, or Group requirements, we have good momentum, and feel pretty confident that we should be able to deal with whatever requirements are made of us.

We move to the next question. We have JP, from UBS.

John-Paul Crutchley, UBS

Morning all, JP here. Two questions if I can quickly again. Maybe just taking a step back on the IB and maybe just taking a slightly high level perspective. Clearly the business has been repositioned and you're getting more of a feel for how this now runs. I mean, clearly, you know, having 40% or so of your tangible equity tied up in a business that's making a better mid-single digit return, or, I guess about 7% if you exclude the CTA charges. There's obviously still probably the most meaningful drag in terms of the Group, in terms of where the Group's currently valued at the moment. We can see the year on year deltas in terms of costs and revenues, and I guess now that you're getting a feel for how this business is actually operating, what do think it takes to actually get this back to more close enough to a Group cost of equity type number? Do you view this as being that fundamentally under-earning at this moment because of the difficult markets we're having? We're all very aware of the cyclical and structural issues out there. And do you think you can actually get that back up through the revenue momentum, or do we have to rethink more about the capital allocated to this business over the longer term? So, a few words on that would be helpful.

And the second point is related. Just on the FX fine, or the FX provision I should say, that's obviously been taken at a Group level rather than at a divisional level at the moment. I just wondered whether the taking of that charge has any impact in terms of how you think about compensation and bonus accruals as you roll in towards the year end, or whether you very much view that as a Group charge, because it's taken a Group level rather than impacting directly on individual business lines and their individual cost basis. Thank you.

Tushar Morzaria

Yes, thanks, JP. In terms of your more broader question around the Investment Bank, we set out at May that we think the Investment Bank for Barclays should represent about, in terms of one measure of capital, 30% of risk weighted assets, and to run it in that proportion. When I look at Group risk weighted assets, they're running at about 31% so I think we're, in that sort of range. And that for us should allow the Group to continue to generate reasonable and growing returns. And even though we had a disappointing revenue print in the third quarter, we were able to increase our profits year on year, and for the quarter. So I think the balance of the Group feels much better than it was. I mean, if you go back a year ago, obviously we were much more reliant on the investment banking division, though we'd never be able to increase capital book value and profits with a decline in investment banking revenue. So I think the balance of the Group feels pretty good at the moment.

But, you're absolutely right, a 7% say return on equity, isn't where we want to be. We want to be higher than that, and definitely closer to or above Group cost of equity. And how do we get there? As you pointed out, there's three levers, revenue, cost and capital. Revenues, a little bit hard to be incredibly specific on what they'll be from any one quarter to the next. We had a better second quarter, and we had a third quarter with some factors that explained that, and we'll get back to more normal levels, I think, over time.

Cost is something we can really control. And costs we're after very aggressively, so we're at the lowest Group costs for five years. You've seen us drop down our cost base three quarters successively. If you look inside the IB, the IB cost story is actually pretty powerful, but it's masked by certain things. So if you strip out CTA for the moment, we're down 8% year on year. Now that's after paying for role base pay, which is £150 million included in that number. It's after paying for additional conduct and litigation charges, which we leave inside the business. It's after paying for elevated legal fees, which is unfortunately a feature of the business environment that we're in.

You know, those three items alone are probably worth about £450 million pounds year to date. And even including them we're down 8%. And, of course, next year we'll have 2012 comp deferrals rolled down, and we'll lose 2011 comp deferrals, and we'll have a bit of last year roll off as well. So I think cost is something we can absolutely get after, and are getting after, and I think that will be an important lever for us.

In terms of capital, the third remaining lever, we've already done quite a bit of action in there by reducing the allocation of leverage, and risk weighted assets that we're allocating out to the IB. To the extent we need to make more modifications, of course, and by the way that's not a question for the IB, that's for every business, so if we see any part of our businesses that we don't think can earn sustainable ROEs in an acceptable timeframe, obviously we will take action. You saw us do that on May the 8th, but that's a broad generic statement in all of our businesses.

In terms of compensation and the effects of the FX provision, obviously compensation as you'd appreciate is a matter for our remuneration committee, and they'll take into account a whole bunch of factors. Now, in previous years, in fact for every year, all conduct matters are always taken into account in compensation, whether it was Libor, whether it was PPI, whether it was swap mis-selling, whether it was other conduct and litigation which probably doesn't have quite the headlines that FX does, and I've no doubt that that will be factored into our RemCo's deliberations around the appropriate compensation for any one of our divisions. So, really no change to prior practice in that regard.

John-Paul Crutchley

That's very helpful, thank you.

Tushar Morzaria

Okay. Shall we move on, thanks. We'll go to Andrew from Citi.

Andrew Coombs, Citi

Yes, good morning. Two questions please: firstly, coming back to this leverage topic, you're £1.32 trillion of exposure, your aim is to go to £1.1 trillion by end of 2016. £140 billion of that is due to Non-Core reduction, so you've got £60 billion on Core. Presumably that's all from the Investment Bank, given the growth you're seeing in the three retail divisions. So perhaps you could provide the latest leverage exposure as it stands today in the Investment Bank, and then also just elaborate on further steps on how you plan to reduce that, be it derivatives, repos, undrawn commitments and so forth. So that would be the first question.

And the second question was just turning to Non-Core. You've seen quite a large provision release there. If I look at the Non-Core wholesale credit risk loans, it looks to have declined sharply, so please could you elaborate on exactly what was driving that? Thank you.

Tushar Morzaria

Yes, so on leverage, I think it's fair to say that when you look at our leverage exposure, approximately £400 billion or so of that £1.3 trillion of leverage exposure is derivatives and secured financing. Obviously that's really sort of legacy and current investment banking operations, and I think that's where you'll see the bulk of the reduction coming from. So it won't be just from those areas, but I think you'll see a bias towards those items, and we'll make most progress against.

And frankly, there you've seen us make most progress in the last 12 months, so it'd be a continuation of that. You know, derivatives and repos, you've seen us bring both of them down. There are a number of ways we do that, they're obviously tri-optima runs, bilateral tear-ups, unwinds, compressions, are a feature of life, and we do that for a living now, and have made good progress on that over the course of this year.

We haven't published derivative notionals, but that's just one way of looking at it. But you will have seen, and I won't call this out because we'll publish it at year end, but you'll see a material reduction in derivative notionals at least year on year already. Repos you've seen obviously come down, the repo exposure and leverage exposure.

Undrawn commitments, we're very stringent in terms of making sure we only extend financing where we see profitable opportunities, and we'll be quite rigorous about limiting our balance sheet where we don't see profitable opportunities, so we will pull on that lever as well.

In terms of Non-Core wholesale credit risk loans, the bulk of that is really coming from Spain, Andrew, so as an accounting matter, because we've announced the sale of our Spanish transactions, it actually moves out of loans and advances and into other assets. So it just drops out of that disclosure, so that's the bulk of what's been going on there.

And obviously, as we close the transaction, you'll see it released altogether, along with the risk weighted assets, which we expect to do around year end.

Andrew Coombs

And the provision release there, did you mean that doesn't relate to Spain? So is that something else?

Tushar Morzaria

Yes, the provision release in Non-Core P&L are some recoveries that came through as a result of name-specific items. Nothing individually significant I'd call out. Although maybe I should touch on this, because it is related. When you look at impairment across the Group, I think consensus was about £2.4 billion at the half year, and I said that's probably a reasonable number to have in mind. It will be a bit lower than that, but our impairment levels, in the fourth quarter, will be higher than they have been in the third quarter.

So it won't be reasonable to just assume a sort of continuation of the £500 million or so per quarter. It will be higher than that. Coming from really three areas: we will be making some changes to our impairment models, particularly in the consumer businesses, that will impact Card, and that'll be a significant increase to card impairment, just in that quarter, as we reset them. That's just recalibrating our models to our own data series.

Secondly, we did see, perhaps to your question, Andrew, some releases and recoveries in the third quarter that are non-repeatable. So it's sort of a slightly artificially depressed third quarter run rate because of that. And then finally, you know, as we get into the quarter a month in, we can see the scope for having to take some particular single name items that will increase impairment in the fourth quarter.

So that's hopefully helpful to you guys to just get a sense of why you should expect to see impairment, and you will see impairment tick up in the fourth quarter.

Andrew Coombs
That's very helpful. Just coming back to the leverage point quickly, I think at the year-end you had £490 billion of exposure in the Investment Bank, the aim was to get to £400 billion. Could you just give us an idea of where you sit currently?

Tushar Morzaria
Yes, we haven't called that out. We give you leverage exposure for the full Core, which is just about a trillion at the moment. The £400 billion for the Investment Bank is on track, and we said we'll get there by 2016 and we'll get there by 2016, and that's now obviously on the BCBS measure, rather than the PRA measure.

The other thing I just want to say is, of course, if you look at leverage exposure, and I mentioned this a little bit earlier, for the Core, it's already running close to 4%, so I think hopefully that's a helpful number for you to have in mind as to how we're thinking about the balance of the Group. But the £400 billion target, Andrew, remains on track.

Andrew Coombs

Thank you.

Tushar Morzaria

Okay, shall we move to Manus, from Autonomous.

Manus Costello, Autonomous

Morning. Thanks very much. My obligatory two questions both refer to a couple of slides in the appendices, actually. Firstly, in slide 28, on your cost targets, you're still looking for £16.3 billion of underlying costs next year, but you've got rid of Spain, or you will have got rid of Spain by then, so shouldn't that number actually have come down a bit for next year? Or are you seeing some inflation elsewhere which has offset the reduction there?

And my second question is on your capital stack slide, which is 34, I believe. You're talking about a 17% total capital ratio. I wonder if you could talk about what you think your TLAC ratio might have to be, because it feels like it could well be higher than 17%, and certainly higher than the 15% you're currently reporting.

Tushar Morzaria

Yes, okay, thanks Manus. In the order in which you asked them. So on cost guidance at the moment, we're not reducing our cost guidance at this stage, we feel committed and will hit the £16.3 billion that we guided for next year. You know, I would say we are absolutely committed to continuing to drop down the cost base as quickly as we can. Hopefully you've seen good evidence and seen us do that over the course of this year.

We started the year at £17.5 billion of guidance, and dropped that down to £17 billion, and, you know, unless FX rates move things in the wrong direction – which by the way would be a high class outcome, because it'll be bigger profits with print, with…

Manus Costello

How much would Spain lower costs by, once it comes out?

Tushar Morzaria

Spain's worth in the order of about £200 million, a little bit more than that.

Manus Costello

And it was in that original £16.3 billion, wasn't it?

Tushar Morzaria

Well, we didn't give specific guidance of the make-up of that £16.3 billion, but I think all I'd say at this stage is £16.3 billion is what we're committed to, and if we can do better than that, we'll absolutely do better than that, and we'll update you as we go along.

Manus Costello

Thank you.

Tushar Morzaria

On the TLAC question, we don't know, obviously, the rules of what is in, and what is outside TLAC, you've probably see the leaked term sheet that we've seen. So I don't know if that's true or not. Our current capital ratio, you saw on that slide, somewhere between 16 and 17%.

If you include senior unsecured issued out of our bank, that will take us into the high 20s. Now, I don't know, I don't think any of us know, whether any of that will be considered part of TLAC. If it is, that's obviously very helpful, but we obviously are capable, and would rotate that senior unsecured issued out of bank into holding company, and we can do that over time.

You've seen us actually do a senior unsecured benchmark issuance already this year, you've seen us issue Tier two out of holdco already, and you've seen us do AT1. So you see us already sort of moving out…

Manus Costello

And what sort of premiums would you expect to pay for holdco versus bank, because presumably this is a reasonable step up in your funding cost over the next few years?

Tushar Morzaria

It's hard to give a prospective number on it. I can give you where we've issued tier two and senior this year, it was about 15 to 20 basis points wider than bank. A little bit of new issue premium probably in there as well. But anyway, that's what we've seen at the moment. But hard to know, obviously, what the future will be, much driven by exactly what issuance, by when, and what type obviously, Manus. But that's what we've seen so far.

Manus Costello

Okay, thank you.

Tushar Morzaria

Thanks. Let's move to Tom from Exane BNP Paribas.

Tom Rayner, Exane BNP Paribas

Morning Tushar, Tom Rayner here. Just a couple on costs please. Your comments you made on the guidance for £17 billion ex-CTA, I wasn't totally sure if you thought you could meet that regardless of the FX headwinds or whether the FX headwinds might mean that you go slightly above that number. But my real question is, when I look at the nine month figure, and I look at the third quarter run rate ex the sort of £100 million of litigation I think that was included in Q3, add on the bank levy, gross that up a bit, you still look like you should be comfortably below £17 billion by a couple of hundred million maybe, unless there's more litigation type stuff in the fourth quarter. My question is really should we be budgeting for sort of 100 to £200 million a quarter for this sort of litigation type of expense, as part of our overall thinking?

And I have a sort of second question on cost to do with the deferrals I mean, I used to model this, I don't any longer, but the impact in the IB of the vesting of the previous bonuses versus how much is deferred from the current year, and as that rolls forward, assuming no big changes in the percentages, the sort of headwind maybe becomes a tailwind.

I wonder if you can update us how 2014 costs in the IB is affected by that dynamic, and how that dynamic changes as we move into 2015, and maybe even into 2016, if you can look that far out on the vesting sort of cycle?

Tushar Morzaria

Yes, sure. Okay, thanks Tom. So on your first question about the £17 billion, just to cover the foreign exchange. So when we committed to the £17 billion, I called out two big caveats, which had to be big for it to be impactful. One was a big move in foreign exchange, and second is anything large and unpredictable when it came to litigation.

On foreign exchange, you know, Dollar, Euro and Rand are the three currencies. And Euro and Dollar we're kind of okay with. You know, Dollar has sort of strengthened again a little bit this month, but that seems okay. Rand is the one to keep our eye on, because that is strengthening quite a lot from the projections we made, at least.

If it continues to strengthen I think we'll be somewhere between £17 billion to £17.1 billion. So I think of that as actually a positive outcome, because it will increase profits, but I think the real heart of your question was what should we be putting in for conduct and litigation. Unfortunately, this is a tricky one to really predict. I'd love to say zero, but obviously it's not zero.

You're seeing it's running at about £100 million a quarter at the moment. Into the fourth quarter, it's, again, too early to tell you, unfortunately, because there are a number of cases that are obviously live, and we're in dialogue on various things, and we'll see if they close or not.

I would say that the fourth quarter, however, is a long close. So we won't be reporting our full year results until early March so that long close period does mean that if anything material happens, it gets reflected in the fourth quarter's books. So it's just something to be mindful of. That's not a prediction, it's just a statement of where we are.

Bank levies are probably one I can help folks with a little bit. We did see an increase in the bank levy rate by about 20% last year, and there'll be a new budget on the 3rd of December, so we'll see if there's any impact to this year's bank levy, but based on where I see our balance sheet ending up, and for a little bit of a guess on foreign exchange rates, and assuming no change to the bank levy on the 3rd of December, my guess is somewhere around £570 million is probably a reasonable place to be. Probably split 75/25 across Core and Non-Core. So hopefully that's a bit helpful.

On the deferrals, Tom, I don't have the page in front of me, and I'm not sure you want to do this, but if you do want to, you can go to – I think it was page 41 or 42 of our full year results announcement, and it lays out there, in quite good detail, our deferral timeline, what rolls off and what rolls on. And it's split by the Investment Bank and non-Investment Bank.

So you could, if you really wanted to, model it for yourself, someone may well have done it, and can maybe send it to you. But broadly, I think you're right, that this could be a headwind in some years and a tailwind in other years. So for example, at the moment it is a headwind, because we had high levels of compensation in the years 2011, 2012 and 2013, than I would anticipate this year, just because we've obviously got a smaller Investment Bank, and performance hasn't been as strong.

Now, if next year we have a blow off year in the Investment Bank, then there's a tailwind because obviously you'll see some of 2014's deferrals for example get booked in 2015. So it does sort of ebb and flow like that. It's a headwind at the moment, but you're absolutely right, it could reverse. And obviously the roll off schedule, I'll just refer you back to that, in the full year announcement.

Tom Rayner

Okay. Thanks very much.

Tushar Morzaria

Okay. Thanks Tom. Fiona from RBC.

Fiona Swaffield, RBC

Hi, morning. I had two questions. Firstly, on the leverage ratio and currency, in the quarter, what would the currency adjusted reduction be, and is there kind of a natural negative from a stronger Dollar in the leverage ratio, I wondered. And the second area was, my understanding is the dividend payout ratio is on adjusted, so before the one-offs, and obviously this quarter you've put where it's large litigation provision, you've put it below the line.

Should I then think, going forward, say 2015, 2016, if there's something sizeable, it doesn't theoretically affect your payout ratio? Thanks.

Tushar Morzaria

Yes, thanks Fiona. On your first question, about £13 billion of FX headwind in that leverage exposure, so if you wanted to see the pre-FX leverage reduction, it's in the order of about £13 billion more. But I know folks like to look at the FX impact on leverage ratios, but the reason why I wouldn't spend too much time on it is because we're actually reasonably well hedged on an FX basis, when it comes to leverage capital ratio. So obviously a headwind in the exposure gets offset by a tailwind in our capital number. So the ratio tells you everything. And the fact the ratio increased tells you what's really going on. It can be a little bit deceptive if you just look at the FX number in isolation.

On adjustments, and the impact of dividends, again, Fiona, there's probably no change in guidance, and this may not answer your question directly, but it's going to be struck, for the time being, at 40% of adjusted EPS. What items will be adjusting items in the future, I can't obviously give you certainty on that, but you've seen this quarter alone, we've put some items at a significant credit of adjusting items, and some items at a significant debit to the adjusting items.

So I think in broad guidance, size is probably important, and the fact that they are probably non-operating in nature is important, but hopefully that helps a little bit.

Fiona Swaffield

Thank you.

Tushar Morzaria

Thanks Fiona. Shall we move to Peter from HSBC?

Peter Toeman, HSBC

Yes, morning. I just wanted to come back on the leverage ratio, because in my way of thinking, is that everything hinges on your £1.1 trillion target for 2016, but within that target in 2016, you still have I think it's £180 billion of leverage in the Non-Core. So I was wondering, if the worst comes to the worst tomorrow, what's the scope for a bit of flexibility here in terms of a faster run up of Non-Core leverage assets getting you to a relatively high ratio?

Tushar Morzaria

Yes, thanks Peter. Look, we've made very good progress in reducing leverage, and increasing capital, quicker than we anticipated, and we're ahead of timetable we set for ourselves - probably about a year ahead on leverage in terms of the 3.5% milestone that we've reached. And our objective function is to go as quick as we can.

I honestly don't think it's helpful to sort of speculate too much sort of one day in advance of what the number will be, and what the date will be. I'm sure we'll be meeting over the next few days and weeks, and once we have that, we can talk perhaps a bit more specifically about opportunities to go faster if we need to.

But I'll just leave you with the comment that we are going very fast, and faster than we probably originally anticipated, and there is £400 billion in derivatives and secured financing transactions that is still there. So I think that's probably the opportunity that we would look to mine the most.

Peter Toeman

Thank you.

Tushar Morzaria

Thank you, Peter. Shall we move to Mike, from Numis.

Mike Trippitt, Numis

Good morning. I just wanted to come back to this question, JP's point about the bigger picture view for IB, and just get your feel around flexibility on the cost base, going forward.

I take on board what you're saying, pretty good reduction, taking into account some of the factors, role based pay, etc, but if there's a slightly heavier outcome on leverage or, whether this is cyclical or structural, we can debate that forever, I guess. But the issue is really just around trying to understand the flexibility on the cost base, particularly going into 2015.

Tushar Morzaria

It is a good question Mike, and I think the difficulty here is it is flexible, but it's not flexible real time. And that's somewhat driven by just accounting and our deferral mechanisms. So I can hopefully give you snippets about why the cost base is coming down even more than the underlying, and we've talked about role based pay, we've talked about, at some point, conduct and litigation hopefully going back closer to zero, and at some point you won't have the elevated legal fees that we have right now, which we do put through the Investment Bank. We could choose to put that somewhere else, but we leave it in the Investment Bank at the moment. And on top of that, we have reduced the cost base by 8%, so hopefully you're seeing the evidence that there is a degree of flexibility in there.

But it's a slightly asynchronous thing that we have. The other thing I would say Mike, and to everybody, we are committed to running the IB on returns, as is obviously the IB itself, obviously more committed than anyone to run it on returns, and we'll continue to, just like any other business, continue to modify and tweak as necessary to make sure we get the appropriate returns, given whatever capital and other regulatory environment that we find ourselves in. So hopefully that helps a little bit.

Mike Trippitt
Okay, thanks.

Tushar Morzaria
All right. So I think we've got one more question. Fahed, from Redburn.

Fahed Kunwar, Redburn
Hi, just a couple of questions. Thanks for the disclosure on the notionals coming down in the derivative books and the Non-Core. I guess my question was more, there's a concern on the Rates business, obviously it's quite long term derivative products. The novation, and the tri-optima collapse in the derivative books, is that on the longer duration products, or are you still struggling to do that? And I guess broadly what I'm asking is, is the maturity of that Non-Core derivatives book coming down as you collapse those notional exposures?

And my second question was on the margin. So you talked about on the mortgage, or the retail side, saving margins getting a lot stronger. It's interesting, because a lot of your peers are saying that the deposit repricing is almost done now, and that's been the case for probably a couple of quarters now. How come you guys have such a big expansion this quarter, and haven't had it in previous quarters? Thanks.

Tushar Morzaria
Yes, thanks Fahed. So in terms of the maturities of our derivative compression exercises, it's actually across the full maturity spectrum. So, as you guys all know, all the sort of tri-optima or bilateral compressions look for are just risk-less portfolios that we can simultaneously tear up without any

market to market transfer, or position change.

So it’s not geared towards any particular maturities, we’re just looking for risk ladders that are market to market neutral and delta neutral, so not biased anywhere. So the notionals will come down across all maturities. This is what you should expect to see.

In terms of deposit margin, yes, we did see a pick-up in deposit margin, as well as balances. I don't think you’ll see that continue. Obviously, deposit rates are actually pretty low, and we’ve seen good inflow into our savings accounts as we’ve continued to lower rates a little bit. And actually our balances continue to go up, and we haven’t really seen that reverse at all, if anything balances are holding quite strong and steadily increasing.

But I don't think you’ll see continued NIM expansion from there, I think that will be broadly stable is my expectation.

Fahed Kunwar

Perfect, thanks.

Tushar Morzaria

Thanks. So I think that’s it for questions. In terms of wrapping up, I think I’ll just leave you with a few points. Remind you what I keyed off on, or finished off on my scripted remarks. Just to remind you; increased pre-tax profits, both year to date and year on year for the quarter; lower costs for the third consecutive quarter, and indeed the lowest cost quarter for five years; improvement in capital and leverage; double digit return on equity in our Core business; continued shrinkage in Non-Core; and of course, an improvement in the book value of the company. Many of you have asked questions on leverage, and what to expect from tomorrow. We’ll find out in due course, but just to reinforce with everybody, I think we have a strong degree of confidence that we should be able to cope with most of the outcomes that may or may not happen tomorrow.

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