Barclays PLC H1 2019 Results

1 August 2019

Fixed Income Results call Q&A transcript (amended in places to improve readability)

Robert Smalley, UBS

Hi. Good morning, good afternoon. Thanks for doing the call and thanks for doing it in a time that is convenient for us in the US as well.

Couple of questions. First on the AT1 calls. I know you have talked about that in the past, but now that we have seen some other AT1 structures, particularly in resets, could you talk about what you are thinking going forward? Specifically, I mean that you did the 8% off of Treasuries with a five year call. Now we are seeing some issuers doing rolling six month calls in reset. Would you entertain that kind of idea in future issuance? And also maybe you could just talk a little bit about the call on the 6.625% [USD AT1 instrument] and some of the economics there, given the back-end and potential being offsides on an FX swap. That's my first question.

Second question, could you talk about the credit card portfolio, particularly in the US. You had talked about 10% growth, CAGR growth. We're not there yet. At the same time a number of other US banks, your competitors, are talking about this area as one of big growth and higher competition, and I was wondering if you were contemplating any changes of strategy there. Thanks.

Kathryn McLeland, Group Treasurer

Great. Thanks Robert. I think I'll take the first question you asked, about our approach to AT1 calls, and then how we think about some of the new features that we've included in our security and what you've seen in the market.

So essentially, in thinking about AT1 securities and the calls and the structures that we use, our approach really hasn't changed. And these securities that we announced the call of this morning, or coming up in September, are a little bit more complicated than some of the standalone securities because they obviously were done as a package and often you can just quite simply look at the economics bond by bond at the back end etc. So for this particular one we clearly look at the FX impact day one, given they're equity accounted. We think about the impact in our P&L, and we do also look at broader implications, impact on our whole liability structure.

Essentially we feel that thinking a little bit more holistically around the calls for these securities, it's still going to be the approach that we're taking. Now in terms of the actual structures that we will be doing, we are going to continue to adapt to market developments, what we see happening, and certainly the change in our back end on the 8% AT1 deals was really designed with the LIBOR benchmark reform in mind, resetting to a government bond. We also adopted the same approach with our Sterling security.

So we will do what we feel is the right structure for market conditions, but also of course what our regulators like. I think we have less ability to do short dated calls post reset. As you've seen in the UK, we typically have a longer non-call period beyond the first call. So for the moment we will continue to adapt our structure but I wouldn't assume any change in our approach to calls of our AT1 securities.

Tushar Morzaria, Group Finance Director

Robert, on the card portfolio, it's a very good question. As you probably know, our card portfolio is primarily geared towards partnership programmes where we tend to run the credit card programme for retailers, airlines and various other companies. We do have an ambition to grow that business, or receivables in those businesses, by 10% and we've been growing below that level for a little time now. We grew again about 6% in US Dollars year on year for the second quarter.

We feel okay with that level of growth. I think of the 10% as a statement of ambition rather than a hard and fast target that we would just drive towards regardless. One of the reasons why we're very comfortable with that is we'd only want to grow that portfolio if we felt very comfortable with the credit being extended. Most of the growth has been coming from the airline type portfolios and the overall type of FICO scores that are driving the growth have been comfortably in the 700s and that feels right to us, given where we are in the length of the credit cycle and various other uncertainties, geopolitical uncertainties, that are around there.

It's a great business. You can see our consumer cards and payments business this morning reported a return of 18% on growing receivables. So it's not something that we need to I think reach beyond that. But if we had the right conditions and the right portfolios came along, I think 10% is achievable. A final couple of comments I'd make on that is we did renew one of our long standing partnership with Wyndham Hotels and Resorts, so we've extended that, which is great, and that was announced in the second quarter.

Most of our partnership programmes are locked up until I think about 2022 anyway, maybe beyond. So it's a good, sticky business with very good risk reward characteristics, and we think growing at appropriate levels at this point in the cycle.

Corinne Cunningham, Autonomous

First one is just about the Moody's outlook. Obviously good news, going to positive. Are there any specific drivers here or are they really just looking for, I suppose, a more sustained return to profitability?

Second question is, you mentioned, Kathryn, just on the impediments to resolution and that you don't really have much in the way of legacy bonds, or you won't do by the time you get to 2022. Just, there is one outstanding that has a make whole clause. You've not really used those in the past, I'm just wondering what your thoughts are towards them. Are you seeing that as a tool that is there to be used? Or is it something that you would only really use in, I suppose, an emergency or in desperation?

Kathryn McLeland

I think you're right. We were very pleased to have the positive outlook put on the Baa3 HoldCo and the A2 BBPLC rating by Moody's earlier this year. You're absolutely correct - our understanding, and we engage with them regularly, is that really the key driver they're looking for is a sustainable improvement in statutory profitability.

I think we feel that, as you heard Jes and Tushar say this morning and we repeat on this call, we have demonstrated a number of clean quarters in a row and certainly feel confident and on track to our returns target for this year of 9% and do hope that we are doing everything that Moody's is looking for. With regard to other aspects of the balance sheet, certainly our understanding is very comfortable with capital levels, liquidity is obviously very high, so really the main driver is just continuing to deliver, executing on the strategy and improving our profitability. And that's looked at very much on a statutory basis.

Your question on impediments to resolution, and clearly we've seen the Bank of England's announcement this week and the final CRR II package around from June, putting everything into legislation. Again, we still feel that the tail is relatively modest, £1.2 billion, and short dated after 2022. So we do feel very confident and nothing that we've seen has changed our thinking. The six year grandfathering was also very much as expected, so it's all quite comfortable.

In terms of the ability to use make-wholes, we've obviously been asked a few times in the past around regulatory calls, and make-wholes clearly are quite a dramatic development and so anything that we would ever be considering we've not thought about that to date, but would have to be really thoughtfully done. Because, as you know, we take our relationships with all our fixed income investors incredibly seriously, we have a very thoughtful approach to funding, and anything that we would ever do regarding any legacy instruments would need to be taken with our bond holders very much in mind.

Lee Street, Citigroup

Hello, good afternoon, and thanks for taking my questions. I've got three, please. Two on credit quality and one on operational risk. So just firstly, with the IFRS 9 introduced volatility in the provisioning line, is there any indication you can give us on how we should think about the potential impact on provisions if the UK were to enter into a period of recession? That would be my first one.

Secondly, on page 27 of the report you give the table that shows the reconciliation movements between different stages, Stage 1, 2 and 3, of the different categorisations. Can you just try to help us understand this a bit better. Just obviously there's been quite big movements into Stage 2, we seem to have £13.3 billion going in to Stage 2 and then £11.5 billion coming out of Stage 2. What's driving this and what would actually cause the overall balance of Stage 2 to maybe balloon a bit more?

Then just finally on operational risk, you mentioned the change to the floors, going from a Pillar 1 to a Pillar 2. Is that just simply going to reduce your Pillar 1 requirement and just equally increase your Pillar 2 requirement? Is that how I should think about it? They're my three questions, thank you.

Tushar Morzaria

In terms of your first point, how IFRS 9 may look in a recession, obviously it's a more pro-cyclical accounting standard than the old IAS 39. I think the gist of your question is how quickly could provisions build if there's a deterioration in the economy.

One way to try and size that is at the back end of last year, and I guess we still have this unfortunately, but we had a lot of uncertainty of the exact path that the UK government would take with regards to Brexit and we felt that the economic forecast that are an input into this provisioning approach wasn't necessarily picking up the degree of uncertainty in terms of the various outcomes. So we took an additional provision. The way we sized that additional provision, and that was £150 million, was to take what we call a Downside 1 scenario.

When we take these provisions, and I'm sorry if this is getting a little bit techy, but we run five scenarios. A baseline scenario, two downside scenarios and two upside scenarios. And we took the Downside 1 scenario, so the less severe downside scenario, and assumed that economic path became our baseline and re-ran our IFRS 9 calculation and added to our provisions using that difference. And that was £150 million.

That Downside 1 scenario was, I would characterise it, as a perhaps regular slowdown. A reasonable reduction in GDP, a reasonable fall in house prices, a reasonable step up in unemployment. Our disclosures, the folks in IR can point to the right pages there, will show what those economic changes actually were. What it wasn't was a collapse like a 2008 type scenario, which would be our Downside 2 type scenario.

In the Downside 2 scenario the provisions would increase much more rapidly, akin to a Bank of England type [stress test] and the reason for that is a lot of the building provisions is actually in the tails. So I think if you have regular way variations in the economy, even mild recessions, negative GDP 1-2%, unemployment going up to 5, 6, 7%, I think these will be more localised provision moves. I think if you get extreme moves, GDP contracting 5%, unemployment getting up to 9%, then I think you get very significant build.

So hopefully that gives you a sense. It's very convex, I guess, to put it another way in the tails. So hopefully that's helpful. The bouncing around between stages is unfortunately a feature of what we're going to be faced with, with IFRS 9, and the way this works is we have to assess the changing probability of default of borrowers on virtually every monthly basis, and certainly quarterly as we report. Small changes in the probability of default will move people from Stage 1 to Stage 2, and of course it could go back from Stage 2 to Stage 1.

To go into Stage 3, you really have to have a real credit event, a number of missed payments and we're also calling you, almost like a defaulted credit by the time you're in Stage 3. So that's going to be less generally noisy, but the movements between Stage 1 and 2 can be quite significant and will just be the way things are unfortunately and the way IFRS 9 works. And there will be a lot of false positives, there will be a lot of moves from Stage 1 to Stage 2, which will go back to Stage 1 again. Some people have criticised IFRS 9, that it creates too many false positives, but that's where we are and that's what it is.

Kathryn McLeland

In relation to a potential move in terms of operational risk from Pillar 1 to Pillar 2, which was mentioned this morning on the call with Jes and Tushar and flagged again on the call just now, essentially we just see this as being beneficial for the market to see us more in line in terms of op risk density with our UK peers. Now we're around about 18%, our peers around 10% to 12%. So it really is more of an optics benefit rather than having any capital capacity increase coming from it. So it will just be a shift from Pillar 1 into Pillar 2, and as we indicated, we're in discussions with the PRA but it's not really appropriate to comment any further in terms of timing or likelihood of this happening.

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