Barclays PLC Q2 2020 Results

4 August 2020

Sell-side breakfast Q&A transcript (amended in places to improve accuracy and readability)

Tushar Morzaria, Group Finance Director

I'll just make some very short introductory comments, just a repeat of some of the key points from the call last week […] to make sure everybody's got those, and then we'll just open up to questions.

One of the most important aspects of earnings at the moment is impairment - what's taken and what's to come. […] In Q2, we booked a £1.6bn P&L charge, and we put out on slide 16 the building blocks for that. Approximately £400m of that charge [is generated by] our models without any updates to economic forecasts [for COVID] or anything like that. Over and above that, we then look at single-name charge-offs [on the wholesale names], so that was about £200m. If we weren't updating our economic forecast and projections, our jumping-off point is about £600m of impairment, and that's not that different from if you go back in the post-IFRS 9 environment: we've been running at approximately £500m plus or minus a quarter, so we're sort of in that neighbourhood.

Over and above that, we again revised our economic projections [for COVID], and that added a further £1bn impairment charge, taking us to £1.6bn. […] I think of that £1bn as the book-up, that's charges that we will take now in anticipation of losses in the future.

If you look at the first half of the year, that cumulative [book-up] over the last two quarters is between £2.4-£2.5bn, so that's what we think will be the [additional] expected loss - it's hard to put an exact time frame on it, but maybe within the next 12/18/24 months sort of time frame.

These models are incredibly complicated. They have a multitude of inputs and you can source your inputs from so many different sources - ask 100 people and you'll have 100 different answers as to what the economic forecast should be. That's completely appropriate of course, no one's got the crystal ball on this. We're all just applying our own forms of expert judgement.

On the models themselves, we have approximately 100 models across all different parts of our books. Again, you get different people to write a model and you'll get different models, and therefore different [outputs]. So there is obviously a degree of variability in both inputs, and the way the models take those inputs and apply them to the book.

We've spent a lot of time looking at the outputs to sense check - do these theoretical answers come to a level that feels appropriate? One of the things we spend a lot of time looking at is our coverage ratios, and we put them out on the slide in our impairment section, which you'll have seen.

An area that we spend a lot of time focusing on is unsecured consumer lending, probably the riskier part of our balance sheet. [Looking at Stage 2 coverage, on non-defaulted consumer credit positions [...], we're now covered there at 23.1%, and that feels appropriately conservative and prudent to us. We also called out where we were for the UK and US cards businesses [overall], at 16% and 13.9% respectively. We feel that's sort of in the right place. Looking at where other banks have reported, we think that's at the upper end of our peer set, and that was always our intention.

I think [...] those coverage ratios look pretty robust. Even if we get differences in projected economic outcomes, I think we'd have to [consider] real hard whether it's appropriate to be taking further book-ups, given these levels of coverage ratios. To give just one […] frame reference, in the global financial crisis of 2008, the UK cards business [had] losses of 6.8%. We're obviously substantially well covered compared to that, albeit with pretty high unemployment levels in those days, but that's a different recession and the government has poured in [support in this downturn].

There would have to be some quite substantial changes for us to feel that our impairment ratios need to be topped up from here, and that's why it is important that we call out what our baseline underlying impairment was before any macroeconomic forecast [updates for COVID]. Of course, that may change in the future as the government schemes roll off and we get real defaults happening.

Moving on from impairment, on the income line for the consumer side, both in CC&P and BUK, we do expect the second quarter to be the low point of [quarterly] income for this year, but we're seeing lead indicators point to income recovering at a different pace in different segments.

Our payments data is supportive of that, merchant acquiring volumes and the types of businesses that are switched back on from an acquiring perspective is supportive of that. We've obviously got some natural tailwinds, just through liability repricing in both those segments as well.

If spend data [trends] continue to come through as it is, and we don't go into further restrictive lockdowns or anything like that, we would think our card balances have plateaued now and should start rising gradually as we go into the remainder of the year.

There are still some headwinds into 2020, particularly in the UK bank. The grinding down of the structural rates could be with us as we stay in a very low rate environment, and that will be a headwind into next year. I'm not sure you'd expect to see an awful lot of growth 2021 versus 2020 [in BUK]. There's so much uncertainty in the pace of recovery and the rate environment that you'll form your own views on that.

In CIB, we're pleased with the strong performance, and the benefit we got from heightened volatility and capital markets activity. Where we go from here is obviously very dependent on market conditions.
The only thing I would say is, when I look at the first half performance, and I've always been keen on looking at these things on a trailing average for the sake of a frame of reference, our year-on-year revenue increase is right at the top end of our peer group, and certainly a lot higher than all the other European banks, probably benching more like the US banks. So I do think that to the extent there are good revenue opportunities, we're getting more than our fair share. I'd like to think that would continue to the extent the market presents those opportunities in the second half.

On the IB fee side, […] we actually had a record fee performance in the second quarter. It was nowhere near as strong as some of the US banks, but in terms of the positive for us, we did achieve that record when some of our more core products, [such as] financial sponsor activity, leverage finance, and acquisition finance, were extremely quiet. The parts of the market that were particularly robust weren't necessarily our strongest points, and yet we did get to a record level. We felt quite good about that. If sponsor activity comes back, then that should be good for us for the second half of the year.

A couple of other quick points, and then I'll open up to questions. On costs, this year's cost shape is a little bit different to previous years. Usually, you would have seen a declining cost run rate as we go through the year [excluding Bank Levy], as our cost actions in the first half of the year would have their effect in the second half of the year. This year's been a little bit different. Obviously, we've put a lot of our usual cost efficiency actions on ice.

We've been very public about not doing any redundancy programmes until September of this year. Even for those folks that we did make redundant at the back-end of last year and the very early part of this year, we actually put them on the equivalent of the government furlough scheme, but paid for by ourselves. You've also got the Community Aid programme, attrition levels have fallen, so we are entering the second half of the year with a higher exit rate than we would otherwise normally have, so there is a little bit of upside pressure in costs in the second half of the year.

So the shape of costs will be different to previously. It'll probably be a slightly higher cost base [in the second half] than first half, which is a little bit unusual for us. And of course, you've got to add the bank levy in there which I'm sure you've already got.

But cost management is still important to us. One of the real positives of the crisis, to the extent there is one, is learning new ways of working, and some of the really quite profound ways in which we've been able to, and the sector has managed to, run their businesses in ways we've never really thought we achievable. I think that's got some really exciting cost potential, but that's really something for 2021 and beyond.

Finally, on capital, we're pleased that we had our highest reported ratio on a transitional basis and a decent distance away from MDA. Going forward, we will eat into that transitional allowance to the extent you get [impairment on] stage 3 migrations. You [don't] get transitional relief on that, so that may be a headwind. RWAs is a little bit harder to gauge. Even though we thought the procyclicality that we were experiencing the back end of April would have continued, markets normalised really fast, and of course we were doing management actions to temper the effects of the procyclicality.

I think you've still got to assume that choppiness in markets is a likely outcome for the remainder of the year. You've got the US elections, you've got the medical crisis, you've got Brexit, you've got the geopolitical tensions. Plenty out there that suggests we may have some choppiness, and therefore there may be some procyclicality that comes through. If it does, that will be a headwind.

Away from that though, if our pre-provision profits are more than covering [impairment on] stage-three migrations, then that'll obviously be positive for us. We'll try and keep you posted as we go into the third and fourth quarter as to how we're seeing that.

Rob Noble, Deutsche Bank

You're running with an awful lot of liquidity. There's a massive amount of deposit inflows. We've seen that across all of the banks. If the money in the system doesn't change, and let's say you can't really lend it out because there's no activity coming any time soon, what do you do about that excess liquidity? Can you reduce your wholesale funding or are you constrained by MREL in some way? How do you manage that?

Secondly, on the ratings migration, what's the actual trigger for credit ratings migration? Do you actually need downgrades from the ratings agency or is there discretion within the models? How does it work for smaller companies which don't have actual ratings? What triggers the migration?

Tushar Morzaria, Group Finance Director

On your first question on liquidity, as you're already aware, deposits are virtually at zero [pricing]. Our Everyday Saver accounts is our largest deposit account in the UK, and you barely earn anything on that. I think that's true of any of the large banks, so I think there's very little action that we can take there.

On the wholesale side, we probably actually ramped up our liquidity again. Q2 was definitely a tale of two halves, where the first half was an extension of what we were feeling in March and April period through to mid to late May. And so we were deliberately keen [on] taking in more liquidity in the wholesale markets, to the extent we had the opportunity to. Fortunately, it turned out not to be necessary as the markets calmed down and particularly as capital markets opened up.

In terms of do we need to be running this kind of liquidity, […] we're not expecting it, but you can never rule it out, [in case] we go into another March/April-type period with lockdowns or [there is] some sort of development in the medical crisis that starts creating a lot of uncertainty. I've always felt that it's always good to be super liquid in a financial institution. Liquidity's the number one thing to have at the beginning of that, so I think we will run excess liquidity quite deliberately.

We've got Brexit as well, which has taken a back seat at the moment. That will probably pick up, particularly as we get closer to the fourth quarter. The political theatre and brinkmanship and all that kind of stuff probably will happen, or could happen, and so running more liquidity than we would otherwise do is probably what we'll keep with.

In terms of MREL, it's a bit unfortunate that the Bank of England hasn't really, like some of the other European regulators, paused or extended or changed the requirements for MREL. I don't think that in of itself is necessarily [relevant for us] anyway I think. We're well on target to get to our end-state. My view has always been that when the markets are receptive, open, and want to buy your paper, then obviously just try to get ahead of that and get to that end-state as soon as we can. That takes the pressure off ourselves, so I don't think MREL's a huge feature for us.

On your second question on ratings migration, no, we don't wait for rating agency updates. We tend to be well ahead of them usually. You've got to remember that, certainly for the larger, riskier companies, we would do our own internal continuous monitoring, whether it's covenant triggers or collateral levels. We're insiders to the company, so we see their financials, subordination levels, etc. So yes, we wouldn't be waiting at all for ratings migration. In fact, I can't recall the last time I had a conversation with our risk officers where an external rating was that relevant. We do this independently and tend to be well ahead of the ratings agencies.

For the smaller companies, we still have our own rating mechanism. It doesn't go through all the extensive complexity that you would for a large complicated corporate, but for smaller companies it's still the same framework. You'd still have a credit officer monitoring those companies. There's an element where it's slightly more automated, as you'd imagine, just given the quantum, but it's still a credit officer-led process rather than just completely algorithmic.

Robin Down, HSBC

Do you have any sense of what proportion of your customer base, and perhaps in particular the cards base, is furloughed at the moment? I don't know if that's something your systems will pick up, whether someone has currently reduced income or whether that's a question you're asking your customers? The second question, on the pension side, we've obviously got this Heron scheme that defers some of the pension contribution [capital effect]. Is that something we should expect to see repeating in future years? Is that something you're going to do again with next year's contribution?

And then the final question, probably a broader, bigger question, but it feels like that UK banking system has not really coped that well with zero rates. I think everyone kind of expects rates to bounce back at some point, and therefore nobody's really thought about alternative plans. Do you have any alternative plans for dealing with base rates staying at virtually zero for the next four or five years? Are you thinking about perhaps introducing fees on deposit accounts or going negative with rates there? Or are there any other alternatives that we haven't thought about that you could employ?

Tushar Morzaria, Group Finance Director

Let me take them in the order you asked. In terms of furloughed consumers, yes, we absolutely do try to proactively seek out those folks who we feel are in a vulnerable position. That could [mean] furlough or they may even have got back into work but are in a sector that's got a lot of uncertainty associated with it. We are able to do that [with] those that bank directly with us, so where we've got current account type information or a long-standing banking relationship where the data can be extremely powerful - you know where their wages are coming from and even, in many cases, the name of the employer. We use that carefully and we're proactively contacting those folks that screen for that.

One of the other cost pressures, and I did talk about this, it's not in of itself the most significant item, but it's one of the things you have in this kind of environment. We are staffing up quite materially our financial assistance department. In old world language, it's the collections department. That's going out proactively and speaking to customers that we screen as vulnerable, and furloughed customers are definitely in that category.

Where it's a little bit more complicated is where, for example, they just have a credit card with us and don't have a broader banking relationship. It's obviously a little bit harder to see. If they've had a card with us for some time, a relatively seasoned card user, then our flags are usually pretty good at picking up those folks that are likely to have some sort of difficulty and we'll get to them in advance.

I don't have any numbers to give you, but it's absolutely a core part of our preventative, pre-emptive actions that we take. It's been reasonably good. In terms of those who took payment holidays, as you can immediately see their wages reduced and stuff like that, you can immediately reach out to them and say are you going to find yourself in difficulty, in which case let's get you onto the right payment plan now, rather than waiting for more and more interest to rack up and causing you a problem.

On your second question, pensions and the gilt-backed note [structure] that we've used, we may do. We've got no plans to do it at the moment, but it's something that the trustees found really attractive. We've done it twice now. We don't really have any plans to do more at this stage, but I guess you couldn't rule it out, but no firm plans at this stage.

In terms of zero base rates, I think for us and the whole industry, I don't think the free-if-in-credit banking model is going to [change] anytime soon or in the near term. I think that will have to be something that the industry consult with policymakers on, because of the problems it creates for both consumers and indeed the banks themselves. It has a whole bunch of negative policy implications in terms of encouraging competition at the zero bound. I do think if we stay like this that probably comes into sharper focus, but that's somewhere out in the future. It's not going to happen in the near term.

In the near term for us, there's no unique way of charging fees, but looking for fee-orientated business is something that's always been high up on our list. We've talked about the wealth business in the past, we would have made quite a lot of progress on that had [it not been for COVID-19]. Now isn't the time to be launching investment accounts, putting them alongside current accounts, and encouraging people into saving using those plans rather than traditional deposit accounts. But that's something we're still quite excited about [longer-term].

Our acquiring business, we're still quite excited by that. It does feel like the move to more online payments is a great thing to have for us. Less cash and more going through our acquiring businesses is a good fee-generating business. Also in transaction banking, away from the UK and more into the international bank, the euro deposit-gathering business has turned out to be really good for us, as more liquidity's found their way to us [and] new accounts [are being added]. As things simmer down, the ability to convert them into transactional banking customers with fee-type schedules will also [be beneficial].

So those are the areas that we've been looking at. In terms of a brand new avenue of charging fees to current account holders or savings accounts, we don't have any plans to do that yet, but the industry may need to [discuss] that with policymakers if we're in this position for a long time.

Alvaro Serrano, Morgan Stanley

A follow-up on credit cards. It does seem that in a low-rate environment, the credit cards book is going to largely drive NII by the looks of it. I seem to remember your comments during the call on the day of results, you mentioned that you would expect not only a pick-up in overall spending, but also credit card spending.

One of your competitors was talking about 5%-10% decreases from now onwards, so a clear ongoing shrinkage of the book. I just wanted to clarify, did I understand [what you said] correctly? And if you can talk a little bit about how you see the demand trends? Is that something you've already seen in July and early August or will it take more time? Just a little bit of clarity around the loan growth.

The other follow-up on cards was, can you remind me how many in the cards book will be your retail customers who hold a current account with you versus external?

Tushar Morzaria, Group Finance Director

In terms of how we see spending on credit cards and how that is converting to balances, I think it's really hard to give a precise answer on that unfortunately. All I can say is that, at this point in time, looking at up to late July data, I would say that the decline in card balances has plateaued.

If spending [trends] continue, and it's obviously more skewed towards debit than it was before the crisis, but the recovery in spending seems consistent. We haven't really seen that [further] dip yet, and I guess those new things have opened up. That's probably not surprising now that we've had a few mini-lockdowns going on in the UK, so that may over time feed into the data.

At the moment, it does feel like spend is consistently recovering. I think over time that ought to find itself into slightly more usage of the credit cards, and then that would ultimately turn into balance. We're not seeing that at the moment. I think it's going to take a little bit of time.

In some ways, that's not a bad thing, because I think you want there to be some sort of confidence that consumers have job security. […] I think external data will tell you that half of folks that were on furlough are now back to work, but that still leaves a reasonable number that are still on furlough. So perhaps credit card not being as actively utilised as they were until we're through that period is not such a bad thing. It doesn't concern me as yet, because it's taking a lot of pressure off impairment.

If we do stay in a gradual recovery, then I think it's reasonable to assume that card balances will start growing at some point, both in the UK and the US. They're actually remarkably similar, oddly enough, in terms of how they've both simultaneously plateaued at roughly the same time, and actually even declined by roughly the same amount, which is quite peculiar given how different the economies are. I think at some point over the back of this year [card balances will grow] if recovery stays intact. Obviously if it doesn't and unemployment surprises on the upside, that may stymie some of the potential growth.

On your second question, I don't know if we have external data yet, but to give you a qualitative answer, it's slightly more than half that have a broader banking relationship with us. It's an open-market product, but the majority of folks that have a Barclaycard also have a different banking relationship with Barclays as well.

Alvaro Serrano, Morgan Stanley

Presumably that's the lower risk part of the book?

Tushar Morzaria, Group Finance Director

Generally, if they bank with us, we tend to end up with a much better credit outcome for sure, because the data is so much richer. We can put consumers into the right place very quickly if they're exhibiting any stress. Much harder to do if you don't have a broader banking relationship with them.

Guy Stebbings, Exane

The first question is on IFRS 9 and macro assumptions. You partly answered it in your intro remarks and the focus on coverage levels, but if we look at some of your peers and the different macro scenarios and weightings, they appear, on the face of it, a little more conservative.

But to your intro remarks, your coverage levels compare quite favourably. I guess it's how the models are applied that ultimately matters, rather than the headline GDP or unemployment assumptions. When you benchmark versus peers, do you consider differences in macro scenarios? Or do you almost entirely disregard that and just focus on coverage levels and your view of the relative riskiness of each portfolio?

The second question is on operating costs in the CIB specifically. […] I'm struggling a bit to think about the shape of the CIB costs in the second half after a very strong H1 on revenue. If we don't really see a pick-up in the costs run rate in H2, we'd be looking at sub-£7bn, which looks very low relative to previous years and the revenue environment, even if we assume a dip in the second half. I appreciate that there's a lot of uncertainty on what H2 revenue might look like, but if we were to take your base case scenario, what sort of shape should we expect on CIB costs in the second half?

Tushar Morzaria, Group Finance Director

On macro inputs, yes, […] I personally put a more weight on the output than the input. The danger with these models is you trick yourself into believing that they're perfect forecasters. The struggle we have is when the models are written, and as I said we've got 100 models, so you can imagine the complexity. These are all super complex analytical, quantitative numerical algorithm models calibrated to historical data, but of course the crisis that we find ourselves in now, the models were never designed to cope with it.

One of the things we found our models really struggle to cope with is the steepness of the decline and the steepness of the recovery. They just overextrapolate on both sides of it. If you just present the model with such a sharp decline, they look through the beginning of the recovery and just completely undershoot, and the same after the trough, you're completely over released. I imagine that's true for many banks. These models have never been calibrated with this kind of data, so that's why we spend a lot of time looking hard at the coverage ratios, because that, as a management judgment, is in a place that is sensible.

To the extent that, for argument's sake, the approach we took to doing our inputs was a consensus of publishing economists, [which is] what we've done every quarter. To the extent the consensus moves materially to the downside, in other words more unemployment, that's something we would have to take note of.

But [it does not automatically mean] that we would feel our coverage ratio at Barclaycard UK, and I'm making this up, needs to go from 16% to say 18% or 19%. I think we would have to think real hard as to [whether] we really believe those projected losses are the things that we should be provisioning for, and look at all of the other data that's being generated out of our models and our credit risk systems.

One of the things I think all banks will be doing, have been doing actually and will have to continue to do, is calibrate their models to any data that is real time to see how good the models have been in forecasting - what did you have in February? What happened over the next three months? Did your models capture that or not? Feeding live data back into your models and recalibrating, so they're living organisms. We don't have that much [relevant] data into this crisis to feed into them to recalibrate them, so there's going to be judgement applied there.

In a nutshell, I put much more weight on the output than the inputs, and indeed the models and the weighting. When we actually wrote our models, we had [multiple inputs and data from different types of downturn]. It's incredible the variety and the different choices we had. At the end of the day, it's an expert judgement as to which ones you choose, but it just shows how variable the choice of models and inputs are. I think outputs are probably the most important thing to stare hard at, making sure that we ask ourselves the questions.

The whole purpose of the accounting standard is to book up in pre-provision expected losses, and coverage ratios will tell you what those expected losses are anticipated to be. I think that's where our judgement is most focused.

On CIB operating expenses and the shape of that, […] let me just mention the performance-related component. […] It may be an opportunity for us in a post-Brexit world, but it's unfortunately smaller than many of our US peers because of the CRD for remuneration framework. It leaves us with quite large fixed pay element, and a smaller proportion of variable pay. So although it's variable, it's not as variable as we would like, and that's actually more problematic on the downside than on the upside typically.

Away from that, on the underlying operating expenses rate, it'll be a similar story to the Group. We actually had quite a bit of momentum from last year's cost actions in the CIB flowing through into H1.

As I mentioned elsewhere, we would normally do our usual pruning, upgrading, and staff management that you would expect all banks to do [annually]. That didn't happen in the first half of this year, so that probably has a bit of upward pressure going into it. [We also had to] put some of the additional efficiency programmes on ice, simply for crisis management [reasons, to make] sure our tech could cope with the extraordinary high volumes and the complexities of doing all of this stuff working from home.

[It] is actually really complex in the CIB, probably the most complex part of it. The amount of hardware and tech that we had to put in people's homes, and much more sophisticated ways of doing compliance and supervision to ensure that we do these things appropriately, are expensive, and that will feed into a bit of upward pressure into the second half.

So it's a similar type shape, but you would expect somewhat upward pressures. I think this [situation] is going to be with us for a while, but we'll get back onto our cost-efficiency programme and start invoking them again. There'll be some progress that we'll make this year, but it'll be delayed progress than we would have otherwise expected.

Raul Sinha, JP Morgan

On costs, I was wondering if you might be able to shed some light on the UK bank's costs base? The reason I come back to it is because, over the last few quarters, the cost: income ratio in the UK has become a drag on your 60% target. You started the year at around 60%, and if you look at the second quarter on its own, it's closer to 70%. If you assume a bounce back in revenues, it's very likely that this is going to be a detractor from your 60% overall target over time.

For example, if we compare that to Lloyds, their retail cost base is [just] 10% higher than your UK bank's cost base, and obviously they have a balance sheet that's almost 50% bigger. Over the years you've talked a lot about reinvesting the cost base in the UK bank, and I was wondering if you might be able to give us the numbers in terms of impact - what additional actions might you take as we head into steady state?

[Additionally,] when we think about new normal in terms of the rate environment, isn't the UK bank probably where you have to do some of the heavy lifting in terms of costs? Related to that, I don't know if you've got an update on the bank levy for us? Because some of the banks are talking about a higher bank levy this year linked to the inflow of deposits.

And lastly, just a quick follow-up on Head Office. I'm just wondering if the lock-up on ABSA has expired? If you could give us an update on when that expires, that would great.

Tushar Morzaria, Group Finance Director

On the first one, […] I think you're right, we're going to have to look hard at BUK. It's been running at approximately, in very round numbers, £1bn a quarter. The income environment, as you've seen, has taken a step back. So I think this is something that we are examining extremely hard - what should be the right level of cost base that we should be targeting, if that's the income [environment we are facing], and how do we get there.

That work is going on behind the scenes, and you'll probably hear more about that maybe at the back end of the year or so. I think the UK bank has not only the structural income headwinds with the rate environment, some of the persistent debt programmes from the regulator, and various other things that have been a [headwind] for income, but it's also just the way it does business has got, in some ways, more complicated as well through the lockdowns.

Even just trying to keep branches open, given security and safety of staff, infection levels, all of the deep-cleaning, PPE etc. Call centres are in the same kind of situation: encouraging people to come back to relatively densely populated call centres is quite complicated as well. We've had to do these in very different ways than we would normally do, and none of that's cheap, but it is something we are looking extremely hard at.

I think there are a lot of really interesting opportunities. Just to throw out one example, [the way] we had to [manage call centers] during the crisis through necessity may have real longevity, and some real productivity [benefits] as a consequence. We turned our branches into mini call centers, as there's a real estate space above our branches. The reason is that people were discouraged from going to their usual place of work, and with some of our voice call centres in India, there was a complete lockdown in India, so it was illegal to operate them. That turned into quite a really good outcome.

It is a good customer experience generally speaking. […] If you ring our call line, you get to your local branch rather than someone several thousand miles away. That is a different experience. The waiting times improved, […] we could manage the load slightly better. In call centres, you tend to have quite high attrition, whereas it declines quite materially if you are using branch-based staff. We are looking hard at all of these things.

We have spent days on this already and have various plans that we are working on. You will hear more about that over the quarters to come. I do not think it will make any real dent this year, but I think it is a necessity. In some ways, it is quite an exciting part, because the opportunities are different to what we may have anticipated, given the new ways of working that we have learnt.

Raul Sinha, JP Morgan

Within the £1bn run rate, could you give us a sense of what are the changes to [branch] costs within that?

Tushar Morzaria, Group Finance Director

I will not throw those numbers out on a call like this, but it is decent. One of the journeys that the industry has been on is a massive digitisation of the industry, [despite being] in a fairly heavy physical footprint business, so the change of [branch] costs are meaningful. […] Just imagine if we did not have that digital work in place, I do not know how we would have been able to run our business. It is all good stuff, but we are going to have to think of a more accelerated way to reset our cost base, given the income environment. […] All I can say is that as a management team, it is probably the highest thing on our agenda in terms of our operational improvement. We will talk more openly about those plans as and when they are ready, but they will have to be quite significant in size. It is something that we will have to do quite quickly.

Bank levy, yes, you are right. For us, actually it is two things. One, we did have a tax credit recovery, where we were able to claim a tax credit from previous bank levy charges. 2019 bank levy was probably a bit lower than the underlying level, and then with more deposit coming in, there is a little bit more pressure. There is probably more upside risks on the year on year on the bank levy. It really depends on the shape of the balance sheet, but probably a bit more upside risks from both of those factors.

On ABSA, yes, the lock up has expired. We have never said anything other than that we are a natural divestor of that for the right price at the right time, so that will happen as and when. I do not think it will be happening any time soon, given the ABSA share price and the risk weighting we have on it now. It actually carries okay, assuming there is some form of dividend coming out of that, maybe not this year but beyond. We will not rush into it, but yes, we are a natural divestor for the right opportunity and that will free-up a bit more capital for us.

Jonathan Pierce, Numis

I have got two questions, one on risk weighted assets and then on IFRS 9. On the risk weighted assets, focusing maybe a little bit more on the credit books. Comparing what is going on there [in RWAs] with the IFRS 9 modelling, how consistent are the assumptions between the two sets of models? I am just wondering why we have not seen more procyclicality yet in the credit book risk weighted asset base, despite all the implicit PDs going up sharply in the IFRS 9 models. Is there regulatory forebearance going on in the background here regarding risk weighed assets? Maybe you could talk to procyclicality in the credit books in the second half of the year a bit more?

On IFRS 9, thinking about reserve releases, Lloyds and [NatWest] are talking about 15% to 30% of the reserves that they took in the first half coming back and pushing down on the impairment charge in the second half of the year. Could you give us any insight as to what you are thinking there on the potential scale of reserve releases in the second half of the year?

Tushar Morzaria, Group Finance Director

In terms of RWA credit for the procyclicality, it is somewhat masked a little bit in our books. We tried to help on one of our slides, where we had that RWA bridge, where you could get a sense of gross credit risk [migration] and the actions going against that.

Now, Q2 was a very strange quarter in the sense that we expected a continuing credit downturn and were getting ready for that, so more and more default, and grade migrations downwards, and perhaps even more revolving credit facility draws. We did not get that, but we had in place a whole bunch of actions to mitigate that. [Consequently,] we got this peculiar effect where we did not get the intensity of the procyclicality that we thought we would get, but our management action did kick in over the quarter. You had this exaggerated effect of those management actions [compared to what] we would have expected.

In terms of forbearance in RWAs, not so much really. I am not sure that there is anything there I would call out. In terms of where we go from here though in our RWAs […], it feels to me, just looking at the environment, that we will expect some form of credit deterioration to take place over the remainder of the year. That will be a headwind to RWAs [...] if and when IFRS 9 forward-looking anticipatory macro models are indeed correct, and we do get that level of default. That will over time feed into our RWA calculations.

If you think about it, IFRS 9 is much more forward-looking than the RWA calculations in and of themselves. There is probably a bit of a timing lag between the two, assuming that IFRS 9 forecasts are accurate. We are assuming that IFRS 9 macro assumptions are the ones that will play out. If they do, then we would expect some RWA procyclicality, […] but you do not necessarily see that until you see those macro things play out over time.

Now, if we are too conservative in our macro assumptions, then we will not get the level of procyclicality that we have talked about, and that is what happened in Q2. You could see our IFRS 9 projections assumed a very sharp, deep trough and we did not get anything like that. If anything, markets became more benign, so that is why we did not get that sort of flow through into RWA as much as we expected.

Your second question, on migration default from stage 2 to stage 3, yes other banks have called out percentages. […] I know other banks have tried to quantify it and I think that is quite a tough thing to do, because of the government support schemes and various inflection points that they create. Whether they are furloughs, whether they are bounce back loan applications still going on, and what have you.

But I would expect definitely some staging migration to take place and that would be a headwind to the capital ratio over the remainder of the year. Against that, if our pre-provision profits are sufficient to cover that, obviously that mitigates the headwind that the capital ratios have, just because of stage migration.

Chris Cant, Autonomous

On CC&P, could you just talk a little bit about how you expect the income line to develop there, in the same way you have talked about Barclays UK?

A minor point of detail, in your macro assumptions you have a second US recession by the look of it in 2022. I imagine it is not that material, but just if you could comment on what is going on there?

On Group costs, I am struggling a little bit to quantify what you are saying beyond the second half being up on the first half pre-levy. At Q1 results, Jes talked about costs including the levy being flat in constant FX, so could you just give an update to that?

Tushar Morzaria, Group Finance Director

[…] On the income line for CC&P, yes, I do think that Q2 ought to be the low point for income. We have had a very sharp decline. Really [there are] two big drivers, both of which are changing and one more tailwind as well. [Firstly], payment activity precipitously declined in a quarter characterised mostly by lockdown. You have seen the data that we have put out there that payments data has shown quite a decent recovery back up.

That's helpful for CC&P in two regards. You have got the acquiring business that is booked there. […] Actually the graph we showed excluded national savings and investments (NS&I). If you included that, payments volumes are even higher than pre-lockdown, but the margin on NS&I is so small that it was probably overstating the effect. But even if you exclude it, it is low single digits lower than it was pre-lockdown. That immediately transmits to income. There is no real delay effect there.

Secondly of course is on interchange fees in US cards. That is still a decent margin fee that we get there, and that will get transmitted to income levels very quickly as well. The other big headwind we had in the second quarter was again the very sharp declining in card balances. That one we have talked a little bit about. I think it has plateaued, and I do not see that increase in the headwind continuing […]. I would expect it to recover, but I think that will take a bit of time and it has plateaued at the moment, rather than recovering.

In addition to that, there is the tailwind in CC&P on the liability side. We were paying 1.5% on our deposits in the US [for most of the second quarter]. We dropped that to 1% towards the back end of the quarter, and last week dropped it again to 80 basis points, so really just following competitive pricing. I think most of our competitors are at 75 basis points, so we may even drop it a bit more. We shall see.

I do expect a recovery in that [CC&P] income line, but at this stage, real time updates are probably fuelled more by the benefit on the deposit pricing and payments, and less of a headwind on card balances continuing to decline. Hopefully that will turn into a positive as we go further into the quarter and beyond, but I think that may take some time to come yet. Spending [recovery] patterns are still more skewed towards debit type spend than credit spend at the moment.

On your second question, you are right in the sense that [US recession in 2022] is not a huge driver of our models. The real thing that makes a difference is […] the change in unemployment and the structural level of unemployment, rather than GDP shape, particularly as you go further out. The forecasted recession is a double dip beyond next year, but structural unemployment is relatively high into next year. That is probably the driving force really in terms of consumer credit outcomes. Even though it looks like a double dip recession, it is really the unemployment number that makes the biggest difference to us.

On Group costs, [compared to] when we were talking at the end of April, I think the costs of running the Group through this lockdown period and beyond into Q3 unfortunately has had slightly more upward cost pressure than we would have liked. Again, I would not overstate that. Jes was saying it was broadly flat, and we are not going to be a million miles away from that, but it is going to be slightly worse […] for the reasons I talked about - slightly more headcount pressures going into the second half than we would have ideally liked, compounded by various other costs of having to do business in a distributed fashion.

As I say, the other exciting thing is the potential future opportunities on our cost base as a result of the ways we can do our jobs in a way we never thought was necessarily that practical. The other thing I would just remind folks of is that cost discipline is very, very important to us. If you go back for the last number of years and [during] Jes' tenure, I think virtually all the years declined in absolute costs, regardless of the operating environment or currency rates, while income is flat to up slightly.

Cost discipline is really, really important and it is going to be very, very important from this point on, given the pressures on the consumer side income. But unfortunately, yes, a slight upward pressure on cost for the second half.

Chris Cant, Autonomous

So basically a bit worse than what we were expecting in Q1 in terms of overall costs, but you are not wanting us to overstate that?

Tushar Morzaria, Group Finance Director

Yes, it is not massively higher.

Rohith Chandra-Rajan, Bank of America

A couple on income and one on credit quality. On CC&P income, the margin looked like it dropped 90 or 95 basis points if I just take the simple average of quarter-end balances quarter on quarter. I was just wondering if you could help me understand what the driver of that was?

Then also the deposit repricing that you have talked about. Clearly, more positive than you mentioned last week. How should we think about where that comes through? Because you have got twice as many deposits as loans in the US. Does the deposit repricing benefit come into the CC&P business or is it spread more broadly around the businesses?

Then secondly, on structural hedge, the yield looks like it is around 100 basis points. Looking forward, potentially that goes to 15 or 20 over the next five to six years. Is that the way we should think about that, moving down in a straight line? So £250-300m headwind per year?

Then lastly, on credit quality, thank you very much for the additional disclosure. It is very helpful. Just particularly on the UK cards book, as you have highlighted, your coverage is well ahead of peers and well ahead of your financial crisis experience. Are there particular characteristics in the book that are driving that level of coverage, or is it just prudence on your part? I cannot really read it off the slide, but any chance you could give us the proportion of the mix of book by the stages on the UK cards business?

Tushar Morzaria, Group Finance Director

[…] I didn't quite catch the first bit of it on CC&P, you asked about balances and the declining balances?

Rohith Chandra-Rajan, Bank of America

No, so it was more around the net interest margin (NIM). If you take the net interest income divided by the loans, it looks like it came down about 90 basis points quarter on quarter. I was just wondering what the driver of that was in the second half?

Tushar Morzaria, Group Finance Director

Yes, on the effects of NIM on there, obviously you have got the rate decline in the US that flows through the floating rate assets, so it comes through fairly directly and compounded by which the balance declines as well. In terms of the second part of that question, all of the deposits in the US […]. Those are the ones I am talking about when I'm talking about the repricing of the deposit rate. That's quite chunky now I guess, from 1.5% at the beginning of the second quarter down to 0.8% now.

On the structural hedge, the way you are thinking about it is right. It will continue to grind down over a number of years. It has been approximately [five to six] year strip swaps, so it will grind down if swap rates stay where they are at the moment and no change to floating, then it will just continue to grind down over time. That is a decent headwind certainly for us and the sector I imagine over that period of time if rates stay this low.

Credit quality in UK cards, yes, I would say that is prudent. We are a broad card provider. We are sort of an index to the UK economy. I know other banks have put out their historical delinquency stuff, and you can get ours as well. We all bench very similarly to the upper end of those stats. There is a slight skew, given we talked about in the past how much is coming from Barclays customers, which I would not overstate, but it tends to be a bit better in terms of credit outcomes we have, given those customers. It is prudence rather than anything. I would not characterise our book being any riskier than any other broad-based card book in the UK.

Our objective with the provisioning was really just trying to get all this stuff as quickly as we can behind us, whilst at the same time remaining profitable, which thus far we have been at least anyway. It is just prudence.

Then your final question on staging, […] I will get Chris and the team to refer you to where it may be. I don't have it to hand, but I imagine as we drew the slides, we probably got to the right scale anyway. If your ruler is good enough, you'll probably get to the right number anyway, but I'll see if Chris and team can point you to the precise numbers in our disclosures.

Rohith Chandra-Rajan, Bank of America

Okay, that would be helpful, thank you. Just to come back on CC&P, what was the deposit number? I think in the data pack it is £67bn of deposits?

Tushar Morzaria, Group Finance Director

The ones that we repriced are the ones in the Delaware bank. Again, I will get Chris and the team to point you to the precise disclosure, so you're getting the exact amount that I am talking about. It's the FDIC-insured deposits that we have in the Delaware bank, which are attached more to the consumer business.

Gary Greenwood, Shore Capital

I just wanted to ask about distribution to shareholders in future. I know the Bank of England is going to review distribution for the big banks in Q4 of this year, so it is possible that they may lift the ban on dividends that they have got in place for 2020. I thought it was interesting that they made a point of saying that distributions were a necessary part of a functioning banking system, so I wondered whether you felt that was a slight softening or increased flexibility in their tone?

Then taking that forward, if they do give the green light for banks to potentially resume distributions from 2021 onwards, what do you need to see in your own numbers in order to start paying dividends again and potentially doing buybacks?

Tushar Morzaria, Group Finance Director

Yes, I think you're right. It was good that they were quite explicit, that they understood how important it was for banks to be able to return capital to shareholders. But I'm not sure it's softening, as I have always found the PRA, generally speaking, quite pragmatic in these situations. Obviously, they took a strong view at the beginning of the crisis and that is their prerogative.

Away from that, I have generally found them quite pragmatic. Historically, UK banks have generally returned quite a bit of capital back to shareholders. I am not talking necessarily a Barclays' story here. In fact, probably other banks have done a bit more than us in terms of giving capital back. I haven't found the PRA having some sort of adverse concern with banks doing that.

For us, we would like to obviously return capital back to shareholders. It is an important part of our investment case. […] I think we need to be comfortable with our own capital position, making sure that's very robust and does not put us in any difficult position. Then obviously a pay out ratio that is appropriate given the earnings trajectory that we have, so let's see where we are going into the fourth quarter. Let's see how the discussions would be, or the deliberations that the PRA will make. We'll also have a better sense of what economic environment we are in for the remainder of this year and into next year. We should be able to make those deliberations. But I expect, to be honest, probably for the sector, nothing much will be communicated until the full year results in terms of distribution policy.

Gary Greenwood, Shore Capital

If you had an outlook that was an improving environment, and you can see the pathway through earnings recovery to capital generation down the line, would you be happy to resume dividend payments, even if you were slightly under your normal CET1 ratio target? Or do you need to be back above or stay above that level in order for you to make payments? Is it mechanical like that?

Tushar Morzaria, Group Finance Director

Yes, I would rather not get into too much hypothetical [speculation]. With these things, it is not just a mechanical list that you go through and out pops the answer. The context, the environment is very important. Generally speaking, I think as long as we see a capital trajectory that is appropriate and we have an earnings trajectory that we have visibility against, those will be the ingredients that go into that determination. It is not as mechanical as we get this percentage on this excess capital. The bank needs to run in a more nuanced way than that unfortunately. But I think it is an important part of every bank's investment case, so we will be making those deliberations.

Gary Greenwood, Shore Capital

I just had one extra question on capital, just in terms of whether the regulator is trying to steer or influence banks in terms of the assumptions they make around the macro? They were all over the place in Q1. It is still to some extent all over the place. I just wondered if the regulator was trying to corral banks into adopting similar macro assumptions, even if they then apply those differently in their models and obviously different shapes of books?

Tushar Morzaria, Group Finance Director

Yes, they have used their convening powers really helpfully to get us together in a way that the accounting profession found much harder to do. [They used] their convening powers to at least aid in the transparency of how different people are thinking about it. They are not instructing us in any way […], but at least they have tried to make information sharing easier. So that as we make our own judgements for our own reasons at least we have a better context in which we are making those judgements. I think it is one of the better things that the regulators have done over this crisis. I think they used their convening powers very smartly.

With that, have a great rest of the day and I'll hang up now. Thanks.

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