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Barclays PLC

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Edited transcript

Jason Napier, Deutsche Bank

Good afternoon everybody, thank you so much for joining us. I'm Jason Napier. I run the European Bank's equity research team at DB. It's a real pleasure to welcome Tushar Morzaria from Barclays. He's the CFO there, as you know. There'll be a brief introductory comment section and then we'll go on to Q&A. Over to you, Tushar.

Tushar Morzaria, Group Finance Director

Thanks, Jason. So just let me take a few minutes, just a few introductory remarks then we'll get into the Q&A. Hopefully many of you have had the chance to see and digest the strategic review that we announced on May 8th. Just a few comments on that.

First and foremost, really we were trying to solve for several things here. One was trying to reshape the Group, such that we weren't as reliant on investment banking returns as we had been in the past.

And you would have seen the capital that the Investment Bank utilises as far as the Group goes, it was over 50% in the first quarter of this year. And you're seeing that we're really reshaping the Group, especially the Investment Bank which will consume 30% or lower in terms of the Group capital from this point on.

The second piece, within the Investment Bank it was very important for us to reshape the business there as well. We were very reliant on Macro, as we define it, which is really Currencies, Rates and Commodities; a Sales and Trading business biased towards the institutional flows. We needed to reshape the Investment Bank to have a better level of diversification within it.

As I mentioned, from this point on, the Investment Bank within the Group will consume no more than 30% of Group capital defined by risk weighted assets and allocated equity. And we will really run the Investment Bank for returns, which is a very important statement to make for us.

We had, in the past, set targets around revenues and growth. But we're very focused on returns and you'll hear more and more from us on this as time progresses.

A few other comments, the feedback that we've received from clients has been very positive. We had an outreach program on May 8th and May 9th, where we reached out to approximately 3,000 of our top clients, particularly in the Investment Bank. And the overwhelming feedback that we received from them has been very positive and effectively, 'business as usual' in terms of the products and services that we will continue to offer in the future. We get our fair share of business from those clients and many of our clients are represented obviously in this room here. So that's been very positive.

The final thing I will just say before we hand over back to Jason is, in terms of measuring progress on the execution of this strategy, there are four things I'll be looking at very closely. And I encourage you guys to focus on them as well.

First and foremost, the core part of the Group, the core bank if you like, should generate double-digit returns really from the starting point. And obviously maybe have some of them fluctuate quarter by quarter but essentially there should be a double-digit returning core offering from the get-go.

Second thing is we should be accreting capital measured by both Common Equity Tier 1 and leverage progressively over the quarters, so that we get to our stated capital ratio milestones in good time.

Thirdly, we should expect to see the Non-Core division shrink progressively quarter by quarter over time. But when I say shrink, I think about three axes: a reduction in risk-weighted assets, a reduction in leverage, as well as a reduction in cost, so that the drag that the Non-Core division has on the whole Group reduces from over 6% for the full year last year to less than 3% in 2016. And you shouldn't expect the drag of the Non-Core division to go outside of those tram lines so it'll be 6% going down to 3% rather than taking a detour.

And the final thing that I'll be very closely monitoring is tangible book value; so capital preservation, particularly as we dispose of assets out of the Non-Core division, we are keen on preserving on capital as best as we can. We'll manage that on a portfolio basis to ensure that we get the right outcomes for our shareholders.

And finally 2014, obviously is a transition year for us, in this regard, the adjustment process really began in the first quarter. Of course, the strategy was announced on May 8th so the full adjustment takes place in the second half of the second quarter. And you'll see the full effect of that, obviously, in Q3 and Q4.

And with that, back to you, Jason.

Jason Napier

Thank you. So Tushar, two things, I guess I thought I'd ask, as you conclude. The first is the ongoing bank is targeted to produce double-digit returns rain or shine and managed 12% last year, and you've spoken about this being a transitional period for the business.

How do you see the mix in core changing in the near term? And having just come up across the hall from the Citi presentation, what is it that you'll be able to say in terms of current trading and how that pertains to mix particularly in the IB in the second quarter?

Tushar Morzaria

Yes, specifically with the IB, and I'll come in a little bit to the other divisions. We mentioned at the time of our first quarter results that the weakness that we saw in Q1 persisted into April, so obviously no change in that.

We also began an adjustment process in terms of repositioning the business in line with the new mandates and the new products and services that we'll be offering in Q1. That adjustment process obviously will continue in Q2 and really will accelerate.

It accelerated post May 8th and obviously the entire trading floor got a new mandate, and having that managed selectively by a very senior group of people, we could then roll that out to the whole Investment Bank.

In terms of the businesses most impacted by that adjustment process, the Investment Banking Division, broadly speaking, isn't really impacted by the model of changes as you'd anticipated. If anything, we're putting more emphasis on that type of business prospectively.

Similarly, the Equities business shouldn't really be impacted materially by changes. And again, the business we like, we'd want to continue to grow and have seen growth in that over the last few years.

The Fixed Income businesses will see an adjustment process. You saw that in the first quarter, you'll see that continue obviously as you make the full adjustment in the second quarter and so forth.

Credit business is probably a little bit less affected because it was already, and again, you saw that in the first quarter, it's already very much vertically integrated into the Debt Capital Markets business. Macro is probably where you'll see the bulk of the adjustment. And that started in the first quarter and will continue in to the second quarter.

Jason Napier

So one of the things in this strategy that's interesting is that you've got the ambition of growing RWAs outside the IB but within the Core by 15% over the period? You get retail, corporate and cards, these are great businesses. Do you think you can absorb that amount of capital organically or do you think you need to use acquisitions for that?

Tushar Morzaria

You know, it will be a combination of both is my expectation. I think obviously the UK retail, UK corporate for that matter, a decent part of our wealth business, are very anchored to the UK and really indexed to the UK economy. The good news is we're growing quicker in all the products and services that we offer than the UK market is.

So an example of that is residential mortgage business in the UK retail bank which has its record high in terms of its mortgage stock share, and mortgage production for the business that we're interested in is growing quicker than the market.

Considering card receivables in the UK, you know we're the largest card issuer in the UK, and it is growing quicker than the UK card market. You see the same in small business lending, and the same in current accounts. You see the same in corporate lending as well. So we'll continue to do well. Obviously geared to the UK economy.

In terms of other opportunities, that's where inorganic opportunities, particularly in cards look very interesting. We have had inorganic transactions that we've done even in UK retail - the ING Direct transaction that we consummated a little while back. There may be bolt-on additions like this, that we may see from time to time. But I think they'll be few and far between.

I think in the cards portfolio, that business has been actually very good at seeking portfolio acquisitions and integrating them, particularly in the US. We've already done some of that this year even, and there's no reason why we couldn't continue to do that.

Interesting about the cards business particularly is that a lot of people think of it as a UK centric business. Now, of about £35 billion or so of card receivables, £15 billion of that approximately is in the UK, so actually the bulk of the receivables are outside of the UK. We're the largest card issuer in Germany, one of the largest card businesses in Scandinavia and South Africa.

Many of you will know about our business there, where we don't use the Barclaycard brand. But it has grown I think, 10 years consecutively. And I think that's more so than any US card company in the US domestic market, where obviously we started from a smaller base.

But we're behind a lot of the partner cards that you see, whether it's US Airways, LL Bean, even Apple point of sales has Barclaycard sitting behind it.

So I think inorganic opportunities in card are very interesting. And then Africa is the other growth engine that we have. Again, there's potential for inorganic opportunity. But they'll be situation-dependent, and we'll see as time goes by, how that works out.

Jason Napier

Consensus naturally has that in Africa there's growth, and you have a footprint in South Africa. There is a One Africa plan and so on, is that the lion share of improving returns in that business for you, or is there much more to do on returns accretion?

Tushar Morzaria

Well, the Africa strategy, we're very geared towards South Africa at the moment. Now, it's a very interesting business. So the whole of our Africa businesses, you've got to remember is a retail bank, a corporate bank, an investment bank, and a card operation.

So all four of the main businesses are housed under a single legal entity called Barclays Africa Group Limited, and that entity is listed on the Johannesburg Stock Exchange. We own two-thirds of that company, one-third is owned locally through local institutions etc...

That's valued at about 1.6 times book and prints a RoE of about 15%. And it's trading at a decent premium to book because the market there locally believes it's an 18% to 20% RoE company. And that's the strategy the local management team has presented to the market.

That RoE is effectively what you see at the Group level, apart from two adjustments that are relevant to Group shareholders. One, there is goodwill the Group shareholders carry on our balance sheet. And the other is there's a bank levy that's applied in the UK but isn't levied locally in South Africa. Even if you strip away the bank levy, just look at return on tangible equity stripping out goodwill, then you get to that sort of mid-teen RoE. So that's how you should think about business.

Over time, you'd see that South Africa probably is about 75% of that business. So you'll see growth in economies that we really like a lot, like Kenya, Tanzania, Zambia, Botswana, which are the faster growing economies there, where we already have many branches and are already one of the biggest local banks in those economies which continue to grow, as well as our South African business.

Jason Napier

So when you look within Non-Core against Core, looking at the Investment Bank again, the ambition is to maintain Core IB against the 15% growth on non-IB Core. So two questions: one, you've undertaken a dynamic management of the business with no sacred cows and returns above revenues. But you're also managing in an environment where 27% of the headcount in that business is due to be restructured.

How do you think about first of all portfolio management in the business? And secondly, retention and motivation of the people who got to come to work and deliver the revenues?

Tushar Morzaria

The second part of your question I'll take first, which is I think geared towards the IB and how do we manage through an obviously complicated transition. Well it's actually working out very well.

I think, when you're going through a big restructuring like this, the hardest part of it is the uncertainty that they have when they're reading about the company in the newspapers or are trying to catch the latest scoop as to what the restructuring will be. And that's obviously quite destabilising and it is difficult to be 100% focused on your job when all of that is going on.

The reaction that we've had post-May 8th has been absolutely terrific. I think almost the clarity that it's provided to people has really created a level of energy within the company that, and I know I haven't been in the Company that long, many people say it's been a long, long time since they've experienced that level of excitement and energy in the building – that there's a clear, coherent strategy that people are getting behind, whether that's in New York, London or Africa.

Some of the town halls in the US business in particular, have been absolutely unbelievable, less “what are you doing for me”, it's “what can I do to help execute strategy”. So we feel very excited about that. I think that difficult aspect of it is behind us. But we shouldn't be complacent about that. Nonetheless, we are shrinking the footprint of the company, particularly in the Investment Bank, quite materially.

I think on the front office revenue producing side, this tends to be a very quick adjustment. And those decisions are really happening and taking place as we speak, and will be relatively quick and people are very mature about that.

It’s a little bit tricky on the infrastructure side. That is a long-term proposition that we will close over time and to have that staffed and to control those as we wind it down is a little bit trickier.

But we have plans in place. We know the people that are impacted. And it's going according to plan.

Jason Napier

Moving onto your second metric, capital requirements and the consumption of capital by individual businesses, the billion-dollar question, really hard to answer but you know, internationally investors have the choice between any number of regulatory regimes. The UK looks like one of the tougher ones.

How do you set strategy or what sort of assurances do you give in a world where we may settle on a 5% leverage ratio ultimately? How do you think about that?

Tushar Morzaria

Yes, I think for us, one of the most important things in this strategy that Antony and I were very keen to get right was to anticipate as much as we can future regulations and to try and deal with that as part of our strategy.

Now we can never be certain, there will be things that we haven't been able to anticipate. But we'd like to think we thought of most things.

And certainly, for me, particularly my role, whether it's a 12% common equity target or it's a 5% leverage target or anything else, that net stable funding ratios could be higher or maybe there's a fundamental review of the trading book that leads to different levels of market risk capital. You know I've been thinking about that a lot and the way I think about it is, if we're running a company greater than 4% leverage and greater than 11% common equity, greater than 100% LCR, greater than 100% NSFR and various other metrics, you know I can go and on – I think that puts us in a really good position to deal with any of the unanticipated changes that may or may not take place.

It's a lot easier to travel to a 5% leverage ratio when you're already north of 4% than where we are at the moment, which is just over 3%. And these aren't predictions, I don't know if it'll be 5%. But we are definitely looking to future-proof the financial and balance sheet metrics of the Company as best as we can and I believe this puts us in a much better position to deal with any of those uncertainties that may or may not transpire.

Jason Napier

In all of these things, was the plan shared with the regulator before it became public? Is there any comfort or colour that we can draw from that?

Tushar Morzaria

Yes, the PRA - I spend most of the time with the Prudential Regulation Authority obviously as you'd imagine. I spent several meetings, several discussions with the PRA. And they really even had various versions of the plan that we were working through to see how it developed.

Now the PRA, we don't expect them to approve business models. They don't say this model will fail based on prudential regulation rules and expect us to run a business in accordance with that. But you can, you know, get a sense of the thinking from their line of questioning and what have you.

And as I say, this plan is designed to pre-emptively address changing regulation in our industry and to position the Company better to deal with that. We think we've done that right. And the PRA has been aware of these plans as they were formulated right from the beginning.

Jason Napier

So the biggest change, and indeed it sets you apart from some of the European peers, is of course the creation of Non-Core, and this being a huge amount of investor interest that we talk to about the profile of [run-off] and the potential drags that you might anticipate taking to get there faster.

What are your thoughts on pace and profile of run-off?

Tushar Morzaria

So as I think of the businesses in the Non-Core division, there are three distinct types. There are whole businesses, an obvious one is European retail. But there are other whole businesses that were transferred from the Investment Bank.

If you recall on one of those slides we showed that there was about £10 billion of risk-weighted assets from non-strategic businesses from the Investment Bank. These are actually really good businesses; quite RoE accretive businesses, some of the best returning businesses. But this is all to do with future regulation, anticipating trying to get ahead of that curve. These are businesses that are great and valuable, but are better owned by other people where banks aren't the best long-term owners for them.

As we exit those businesses, they'll be episodic. There'll be classic investment banking-type mandates where there'll be strategic buyers who'll be interested in those businesses, and we will run a process to structure the deal in the best interest of our shareholders.

The risk for this is that those businesses attrite before we're at the point of sale and we lose value. I think that's a relatively low risk in this case because the principals involved in running these businesses, their interests are very much aligned with ours. As they look forward to their new owners, they want to create and retain as much value so that it's interesting and attractive to new owners as it is now. So I think that's a relatively low risk.

The second category I guess within Non-Core are individual line item securities and loans and similar. This is very similar to the Exit Quadrant Assets that we had of old. And actually in many ways, similar to the large sort of structured credit-type wind down that Barclays undertook during the last days of the financial crisis.

So here, the business has deep experience in how to deal with unwinding these securities and these loans. Some of them are situational; there'll be ways in which we can create a situation that unlocks value either by changing the structure or it's a refinancing or something like that. And some of them would just be assets that we either run down because we're better off receiving par in a discernible timeframe, or will auction them and sell them within our marks.

The risk there is there’s a strong bear market that snaps very quickly, that will force us to remark positions just like you would at any other bank. And that'll be what it'll be. But again, outside that, that's a relatively well-trodden path for us.

And then the final block is the derivatives book, which has tens of thousands of transactions. The trick there is less so market risk. These things tend to be quite manageable and even in relatively volatile markets, we have the experience to manage those risks quite well.

It's more the operational cost associated with running down a large derivatives portfolio. We need to refix trades every day; we need to process cash flows; we need to make collateral calls and client valuations, reconcile trades to clearing houses etc…

So it's an expensive infrastructure to keep. And the trick there is to reduce those operational costs as we reduce the size of the portfolio. We have very clear plans and strategies of how to deal with that. And we feel very good about it.

Those are the three categories of activities and they're all with their own different types of risks. For the plan laid out, we feel very comfortable get to the targets that we set out on the 8th.

Jason Napier

So it's a cheeky one, but I wondered whether you wanted to comment at all on press speculation that the sale of southern European retail is maybe close?

Tushar Morzaria, Group Finance Director

Yes, it's a cheeky one. I'm not going to comment on press speculation. But it's fair to say that we're in four countries in European retail. The two largest countries are Spain and Italy. These businesses are probably most attractive to other banks, local banks. They're very high quality businesses with very good characteristics for a local bank which is looking to grow and consolidate, so really somewhat dependent upon the state of the banking system there.

It feels like that there's probably more activity in Spain. You're seeing Citibank’s deal with Banco Popular and there are a few others. So it feels like, you know, there are some options, or some opportunities in Spain that may or may not happen, maybe in Iberia generally.

It feels less so in Italy but, it will depend, and we're very committed to running those businesses as going concerns. We have terrific managers of those businesses locally. They are on a path to breakeven for us and that's a pretty good achievement. We continue to be happy to own those businesses as long as needed. We're in no rush to sell them if we don't get the right buyer and the right type of owner.

Jason Napier

Because it's interesting, in a lot of ways, the numbers behind your plan are pretty straightforward for the market to interpret - 6% ROE drag, falling to 3% over a period of years. To the extent that most of last year's drag was bad debts in those sorts of business, is there really fairly low risk assertion that 6% is the big number and it's definitely going to be less in the next few years? How do you tram-line this?

Tushar Morzaria

Well we've guided to folks that they shouldn't anticipate losses to get greater than 6%. There should be a steady progression from 6% down to 3%.

You're right about that there was a lot of impairment in last year. So a lot of the pain, if you like, has been taken particularly for those businesses.

Offsetting that, some of the revenues that were ascribed to the Non-Core division aren't recurring revenues; these were transactions that we did last year that we won't be doing again. Things like you know, large complex, long-dated derivatives in the very early part of 2013, maybe tax structures and proprietary. Those aren't repeatable I could say.

So you'll see some revenue fall off just because of activity that doesn't exist, but you wouldn't expect to see that level of impairment this year.

Jason Napier

When I try to do my simple models, one of the problems that I have is line of sight on Non-Core costs. You kind of use it to balance the Group number because we have it. What are the plans around cost rationalisation to offset the revenue pressure you're talking about there?

Tushar Morzaria

It's a good question. I think the bulk of that really comes from two aspects; whole businesses, like European retail. Those costs will go when the businesses are sold and it's literally as simple as that.

The other big category is really the derivatives infrastructure. And our strategy around that is, in some ways, quite simple. In the Core Investment Bank, we'd like to put the entire Macro trading businesses, Rates, Currencies, Commodities onto a single system that already exists, so that affects infrastructure. Some of you may be familiar with the BARX platform that we had out in the market as ways in which clients can trade foreign exchange with us electronically.

We believe that's the best technology that we have and suitable for those businesses, and other people have commented that it's a pretty good technology. So we will port new business and old business onto there. That leaves the legacy rates platform, which will go to Non-Core. And that's the business that as the portfolio shrinks, we'll look to rapidly shrink the amount of operational overhead that goes associated with it, while maintaining control of those books.

It's not like running a fully-fledged functioning, open for business trading floor. So you don't need all the heavy costs associated with that, it is a rundown portfolio so the costs will come down as the portfolio shrinks.

Jason Napier

And in some ways, I guess, we're in a pretty strong market for financial assets generally. The £50 billion of RWAs which you guided will still be there, you know, three years out. Is that a straw man target that you can destroy, or do you really just think long-dated, this is a gradual run-off scenario for you?

Tushar Morzaria

The way I think about that, of that £50 billion, £16 billion comes from Europe retail. And we've assumed that hasn't been sold, maybe sold, maybe it hasn't been sold. But it will come and go as that business comes and goes.

That leaves somewhere between £30 billion and £35 billion from outside of that, principally from the Investment Bank. Now, if we're running the Group at about £400 billion of risk-weighted assets, then that's somewhere between 5% and 10%, nearer 5% of group risk weighted assets. So that's getting to the level of size that it becomes very manageable in terms of scale.

So I think on the capital side, we see a good path on how that capital requirement does look increasingly small and minor in the scheme of things. The success of the strategy will be that the cost side looks equally sized along with that. And that's back to my point that I think the key to this will be able to demonstrate to investors that we can shrink the costs associated with the derivatives portfolio alongside the actual capital reductions. And that's what hopefully you'll see over the next few quarters.

Jason Napier

Thank you. The final metric that you brought up was TNAV preservation. And it doesn't feel like, if the drag from ROE is going to fall from last year's 6% in Non-Core, it doesn't feel like that's too difficult an undertaking. Is that an undertaking that you're seeking to achieve at a divisional or a portfolio level? What does that mean in the sense that you're a profitable business, you're a long way from breakeven?

Tushar Morzaria

Tangible book value - we think of it as a Group target. Although in my own mind, I know how I think about it by division. But as far as I think investors should look at it, they should look at it at the Group level.

It's important for us to preserve tangible book, you know as much as we want to improve our capital ratios, we don't want to do that because we've just been reducing risk weighted assets. We want to do that because we've got real capital that's accreting in the business as well.

As we run down Non-Core, we will look to preserve tangible book. But we won't be slavish about it. So an example would be, if we have the opportunity to exit a country at a cost to tangible book, at a dilution of tangible book that was small and modest, but at the same time, it was very accretive to Common Equity Tier 1, very accretive to return on equity, it may well be the right thing in the interest of our shareholders to do that because you are away from the distraction of being inside a country with having to deal with local rules, regulations, management.

So I think we'll make those trade-offs as we go along and we'll manage it as a portfolio effect. There may be some asset disposals or reductions that may be dilutive to tangible book, offset by others, but maybe accretive. Some business we'll sell at very healthy book profits. So we'll manage it as a portfolio.

These business sales will be episodic and you know, the sequence, I mean, it's very hard to predict. But you should expect us to look to preserve and grow tangible book over time. We'll not be slavish about it on any individual quarter.

Jason Napier

Any other questions from the floor? Yes, we'll get you a microphone.

Unidentified participant

Thank you very much for the presentation. I do have a question on the industry, specifically on litigation cost. It seems that there is a sharp inflation in litigation cost and to what extent is it going to be a risk to the banking system? And when do you see that cost inflation abate? So at what point will we have banks without any material litigation costs on an annual basis?

Tushar Morzaria

It is a very good question. As you rightly point out, there's been a real inflation in litigation costs. And it seems to be increasing as we speak. And it's hard to see from where I sit, in my role, when that's going to stop. I can't see a catalyst as yet.

All I can say is that the plans that we've put in place have tried to take into account some potential for increased litigation and still reach the targets that we've set out in terms of capital, as well as returns.

So although we can't be absolutely certain about it, we have been prudent and not being blinkered by not thinking there'll be unknown unknowns, if you like, from a litigation perspective, that we should have some buffer to guard against.

But really, to your point, can I foresee the year in which we can say that litigation has been 100% behind us? It's hard to be definitive on that at this point.

Jason Napier

And we're going to thank you, Tushar, for joining us today. Thank you.

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