

Barclays PLC Q4 2019 Results

13 February 2020

Results call Q&A transcript (amended in places to improve accuracy and readability)**Alvaro Serrano, Morgan Stanley**

You're clearly quite confident, as you said, to deliver a meaningful improvement to ROTE this year. I've got two questions. First of all in the IB, what kind of revenue environment are you factoring in – or do you expect? Can you hand hold us a bit there, because obviously FICC was very strong last year. You had gilt gains in there, you had Tradeweb gains, so it seems like you might have some revenue headwinds. So what kind of revenue environment would you expect given the start of the year?

And secondly, can you give us a bit more colour on costs, related to the flexibility you've quoted. I'm not sure if you can give us the comp ratio that you gave us last year in the IB, but if not, a bit of colour around what are the non-comp trends last year and what we should expect for 2020, and where you retain that flexibility? Thank you.

Tushar Morzaria, Group Finance Director

I think the backdrop of your question, generally speaking, is where do you see our returns improve from here, and what are the drivers. And I know you sort of focused in on the investment bank, but it may be helpful if I just give you a backdrop of some of the momentum that we've got across all of our businesses.

[...] we're pleased with some of the momentum in our UK business – pleased with the mortgage growth, pleased with deposit growth. We have seen a little bit of stabilisation of interest margin in the mortgage business and we'd hope to continue to grow balances there.

I think the other thing that we're seeing is probably some softening, continued softening I guess, of our unsecured balances, but again it's the backdrop of a relatively benign credit environment. You may have picked up from my scripted comments our impairment guidance is probably a bit higher than we'll expect to see.

Within the CIB we are pretty pleased with the performance that we've had this year, and actually I don't think it's just one year – it's really over three years. We've shown a slide that has our revenue performance improve against a consistently downward industry revenue backdrop.

None of us have the crystal ball on which direction revenues are going to go in this year or beyond, but what I would say is that even in a down market we've been able to improve the returns and the profitability in the CIB over [the last] three years. And just away from sort of pure investment banking revenue, where you've seen our market share improve, and we've published some stats around that, you've seen the return on risk-weighted assets in the corporate bank improve. You've seen us talk about some of the

momentum that we have in transaction banking, particularly in Europe and some of the growth we expect to see there.

And likewise in the cards business. I think you'll expect to see, I'm talking about US cards here, continued growth in balances and therefore profitability.

On the cost side, again the broader backdrop is disciplined cost management. We've had our costs reduce over a number of years now consecutively, in pound sterling with everything included in there.

In terms of the comp pool around the investment bank, we haven't published that ratio but what I would say is we did talk about having comp flexibility to ensure that we could flex our cost base to the income environment, and of course you've seen that – the investment banking industry [wallet] is down year on year and you'd expect us to factor that into the compensation awards that we would have.

Trends around non-comp, we've put a slide out there on a whole bunch of activities that we have going, whether it's in real estate, whether it's in the use of suppliers, whether it's decommissioning applications, and we show that we have over £500 million of gross productivity. We continue to see momentum on those initiatives and the new ones going into 2020 and beyond, and again that would give us flexibility to manage our cost base accordingly depending on the environment that we're in.

The final comment I'd have before Jes may want to add something is that positive operating leverage is important for us, and we're pleased that we got positive operating leverage across all of our businesses this year both in the quarter and for the full year. We'd like to continue to drive our cost income ratio down, so that's something that's quite important to us.

Jes Staley, Group Chief Executive Officer

Maybe I can add that for the longer term, my own point of view is that the sheer size of the capital markets continues to grow, and the capital markets continue to replace bank balance sheets in terms of funding economic growth. Concurrent with that you have seen capacity leave the intermediary space as banks have pulled back. Those two factors at some point I think should start to have an impact on the overall revenue characteristics of the intermediaries in the capital markets.

Jonathan Pierce, Numis

Two questions please. First one on your equity tier one trajectory in the first quarter. Last year you had a 20 basis point drop in the first quarter after IFRS 16, which is obviously impacting there a little bit, and the neutralisation of share awards and so on and so forth. Is that what you're expecting – or maybe a touch more because I guess securitisation add-on is a bit more than IFRS 16, but is it that order of magnitude in Q1 – a sort of 20 maybe 30 basis point max drop in the equity tier one this quarter?

The other one is connected with risk-weighted asset growth more broadly over the year, and how you see the trade-off this year between organic growth and securitisation, mortgage add-ons? If you can give us a bit more colour on that. I also note that it's probably connected to the improved impairment performance as well that the asset quality movements appear to be negative now. So I'm just wondering in the balance for this year, pro-cyclicality growth, regulatory add-ons, how do you see RWA's moving over the full year as a whole please?

Tushar Morzaria

So on the near-term move on CET1, you're right, obviously we called out the securitisation inflation, just the change in the regulatory rules that will flow through, as well as the regular seasonality that you would expect with Q1 typically being the most profitable quarter – but isn't always the case.

You sort of said 20 basis points last year, and is that a sort of similar thing to think about this year. I'm reluctant to quote a number, but it's not unusual to see that kind of move in Q1. So look, I'll let you model that as you see fit but I don't think you'll be that far off the mark there.

In terms of RWA evolution over the year, in terms of regulatory inflation, the other one in the pipe that you've called out is mortgage risk weights, and we've sort of guided to that – no change in guidance previously. Again those sort of [low] single digit [billions] type impact.

Beyond that, I don't think we'll be utilising a lot of RWA inflation to fuel the business activity. It's pretty modest in both the consumer businesses, and in the CIB it'll sort of bounce around over the course of the year, but I don't expect much significant growth.

So I think if you're in a roundabout way thinking about how much profitability gets absorbed by reinvesting onto our balance sheet, I don't think it'll be significant compared to previous years, outside of the regulatory inflation that we've talked about.

Claire Kane, Credit Suisse

So Barclays UK income, obviously Q4 was a bit higher than maybe the other quarters, and you mentioned the treasury gains and the debt sales, but if we look year on year non-interest income was up £110 million. How much of that would you assume is sustainable? Do you think the FY19 print is sustainable for 2020? That's my first question.

The second question then on costs for Barclays UK, you mentioned the investment spend. Can you give us some indication of how the investment spend for 2020 is compared to 2019 and if we should expect absolute costs to be higher in the first half of 2020 than the second half? Thank you.

Tushar Morzaria

In BUK we did call out debt sales – don't confuse these with debt sales from our liquidity pool. These are just selling low-rated receivables essentially, we do that as a regular part of business. I'd encourage you guys not to think of that as a non-recurring item. It is a recurring thing we do every year. It just so happened in 2019 the bulk of it was actually in Q4, so it sort of squashed up together a bit, but if you go in previous years it's normally more evenly across the quarter and it's just a regular thing we do every single year. So I'll let you model the line with everything else that's going on there but I wouldn't be stripping out too much in terms of one-off impact there if any.

Claire Kane, Credit Suisse

[...] is it sustainable?

Tushar Morzaria

I think the headwinds that we have in BUK is mostly the rate environment. Obviously with the lower and flatter curve some of the hedges that we have in place are going to be less meaningful than we had in the previous year, and I sort of called that out in earlier calls.

I think on fees and commissions, things like debt sales and other things... I wouldn't think of them as a non-recurring [item]. The only other thing, if you really wanted to get into the micro of modelling, is just be a little bit careful with overdrafts. That's sort of switched around a bit from fees into net interest income again. So it's broadly offsetting, but the geography may be different.

Jes Staley

If I can just add two things on the cost issue. One is as we move from spending all of our money to 'run the bank' to having the balance to 'run the bank' and 'change the bank', what that does give us – and I think we did some of it in 2019 – is more control over our cost line.

And obviously we want to invest for the future and for growth and we will, but [with] discretionary spending you've got greater control to manage that during the course of the year, and I think another thing we showed during this year is variable compensation is variable. We're going to match our costs and our compensation management through the course of 2020, much like we did in 2019 with very much a focus on the profitability of the bank.

Tushar Morzaria

Yes, and Claire just to round off that point you asked about the shape of BUK costs. It will be frontloaded. I sort of called that out in my scripted comments, so do expect a higher cost trajectory in the first half relative to the second half. And that's really because of the continued investment spend that we have around managing our real estate footprint, as well as some of the digitisation activities going on, if that's of any help in your modelling.

Joseph Dickerson, Jefferies

So first of all what are the milestones you need to see to gain more comfort around, for lack of a better word, certainty, on the UK to release the overlays you've taken? Because it's hard to see in the macro backdrop anything getting worse - if anything surveys point to the contrary. So what are the milestones you need to see, and the timing associated with releasing some of the overlays you've taken as a result of the uncertainty?

And I suppose in a somewhat related manner if I look at the top two lines of your assets on the balance sheet, the cash and cash equivalents have been moving up quite a bit, and they're now 20% of tangible assets, and the timing of the increase on those seems to have also corresponded to the post-referendum world in the UK. So you've hit yourself both ways, both in terms of having cash in the excess liquidity and then the impairment overlay. On the balance sheet do you see this number coming down over time as some of the certainty comes back into the picture? What is it we need to see and look at as a milestone for those things to unwind? Thank you.

Tushar Morzaria

Why don't I cover those two, and I may hand over to Jes to maybe talk about how he sees the UK environment generally, which I think is the crux of your second question. On the impairment overlay, just for those that may not be as familiar, we did take a charge in the fourth quarter of 2018 of £150 million related to uncertainty around the future economic forecast around that period, given all the political uncertainty and [...] where the UK may have gone. And we've put that provision in place right through to 2019.

I'm not sure there's a numeric quantitative trigger point to your question that I'll call out. What I would say is that as we assess each quarter whether we have a better, tighter set of external data to project our forecast on, there will be less and less need to have that uncertainty overlay, and that's just an assessment we'd make every quarter.

On the liquidity on our balance sheet, I mean some of that you're right, is driven by customer behaviour. A lot of cash being left on our balance sheet rather than demand for credit. You see that particularly in small business and corporate type activity. It's worth saying that sentiment qualitatively feels better. I don't think you can say that's transmitted into actual change in demand for credit or a drawing down of those cash balances into credit assets, but if the sentiment continues to improve we would look forward to seeing that, but I can't say we're seeing that yet. Anything you want to say on the UK environment Jes?

Jes Staley

Obviously having the political uncertainty of Brexit behind us, I think you've already seen it as a positive thing. You've already seen it in business confidence, and discussions with both international and domestic businesses we see relief in terms of that political issue being put behind.

We obviously have trade negotiations both with the European Union, and what's possible now with the US. The other thing we're all too mindful of is that clearly the current government is comfortable [...] to increase the fiscal deficit as a percentage of GDP, and to the extent that is invested in infrastructure it generates capital and that's also very positive for the economy. So I think one has got a more positive outlook today than one would've had a few months ago.

Andrew Coombs, Citi

If I could ask a couple of questions please. First on CIB revenues and second on costs and the ambitions for 2020. On CIB revenues you made the point your markets and banking fees are up 9% from 2017. That has been partly offset by a decline in the corporate and transaction bank, and both are down year on year again in the fourth quarter, which I think you draw out due to mark-to-market on loan hedges. I'm interested in your thoughts on those businesses, particularly corporate lending, but also the transaction bank going forward. You've talked about a number of initiatives. You've talked about five to ten percent growth per annum in transaction banking and annuity revenues. But to what extent do you think you can offset the lower rate environment? Are you confident that that business can grow versus what we've seen in the past?

And then on costs, if I look at slide 23 – the £550 million savings – you've not quantified anything for 2020. More broadly you're now talking about positive jaws rather than an absolute cost focus. So is it fair

to say the priority is not for an absolute cost reduction anymore, and it's much more about the cost in relationship to the revenue, and it will ultimately depend on the top line going forward?

Tushar Morzaria

On your first question, on transaction banking and corporate lending. The corporate lending line can be a little bit noisy because of the hedges going through that line. I think the gist of your question is that if you look through the loan hedges – take maybe a trading average or something like that – so you see through that noise, is that stabilised? I'd say it probably has, but obviously it's somewhat driven by the rate environment. But I think it's a reasonable jumping off point. Obviously the returns on that lending book has increased so the productivity of the capital we have against that book has improved. You'll see a slide on that.

On transaction banking, this is an area we are quite excited about. We've talked about a European transaction banking offering to our clients. We've talked on the slides about adding 300 or so clients, attracting about 10 billion or so of euro deposits. [We are] expecting that to grow and expecting the annuity revenues to be growing at sort of five to ten percent, high single digit type territory. And we feel very good about that.

Jes Staley

We talked about improving the return on risk-weighted assets by 90 basis points. We don't give the actual number of return on risk-weighted assets, but that's a meaningful increase over the last years in terms of transactional revenue, versus our revenues from extension of credit.

[...]We've completely reengineered the front office of our corporate banking offering across Europe. So before it was reliant on the bricks and mortars of our branches in Italy and Spain. That's all gone now. We put a whole new front office system, and out of the box in the first year we had 360 good-sized corporate clients across Europe that delivered some 10 billion of euro deposits. So that's a whole other, if you will, geography to feed into transaction banking.

Tushar Morzaria

I guess just to round off that point Andy, the other thing we're seeing good progress in is the connectivity between that corporate payment business and our payment acceptance business, and you've seen the roll out in Europe as well, and the connectivity and the cross referrals of clients. That is something we feel very, very good about.

Going onto costs, yes we've had a fixed cost target for a number of years now – I mean virtually ever since I've been here, and hopefully you've seen us delivering against those objectives every year with costs going down virtually every year as well.

I think as the company sort of completes its [intense] restructuring and various other reorganisations, which we had to do on the backdrop of change in regulation and ringfencing and CCAR and Brexit and all the kind of good stuff that's gone on there, we're more and more focused on operating jaws and we want to drive that forward. So I think you'll hear us talk a little bit less about absolute cost targets, but very much trying to drive positive operating jaws. As you said Andy, cost tracking income, but with a bias towards positive jaws, and again I'd encourage you to look at that on a trend basis. For example in the UK bank we will be frontloading some of the investment spend for this year – I'd encourage you to look at the positive jaws on a trend basis rather than literally every single quarter.

Chris Cant, Autonomous

I wanted to come back onto capital if I could please. You've indicated that MDA head room is not the only consideration in reiterating your c.13.5% CET1 target, but you're now in effect saying that 100 bps of headroom over MDA is acceptable. The slide [shows] you expect your MDA to go to 12.5%. You used to target 150 [bps of headroom]. The only other banks I'm aware of in Europe targeting such a low level of headroom to MDA are Piraeus and Novo Banco. Could you explain a little bit more why you're happy to run with a lower headroom than basically all European peers' targets?

And as a follow-up question, this can be my second question, you still state c.13.5%, but that would imply that you would be happy to run a little bit below 13.5%, which would be less than 100 bps of headroom. So could I please confirm that you're happy to run with less headroom to MDA than the likes of Novo Banco?

Tushar Morzaria

I must admit I don't track all the European banks that you seem to track. I don't have those particular numbers to hand, but what I would say is we do look at capital target level for us against a number of lenses. You know distance to MDA is important – obviously it's particularly important because of the dividends stoppers and various other restrictions that are in global spend.

About 100 basis points is over £3 billion, and we have run a wider distance to MDA in the past. Now in the past of course we've had quite significant conduct and litigation type items that have been running through our capital line, as well as extensive restructuring. What that does is make some of these charges quite episodic and large in nature, and therefore we felt it would be very prudent to be running a wider distance to MDA while that was going on, and I think you should expect to see a bit less of that now. So I think that's one thing.

I think the other thing of course is you know distance to MDA is important, but so is stress test capacity, PRA buffer capacity, and various other things that are linked to that.

The other thing I would say is – it's a little bit speculative I guess – but we're all assuming that the countercyclical buffer does come in at the end of December, and of course that's a stated objective of the FPC and the Bank of England. Were it to come in at that time I think you would expect it to be alongside a very buoyant, healthy economy. You'd expect it to be a very positive operating environment that ought to be beneficial to profits as well. So I think you should look at it in the context of that. And on the flip side, if the economy is going into some form of stress or difficulty, then I think the FPC have said they would not invoke the countercyclical buffer – in which case our distance to MDA would sort of automatically recalibrate to where it was. So I think it's just important to look at all of those things in the round, rather than on one particular item.

Now you've asked me this several times in the past, it seems to be a theme that comes up – what does c.13.5% mean? Would you be prepared to go below 13.5%? I think the way I always think about these things is that there are a lot of things that sort of go up and down when you're managing an organisation of our complexity, and we don't manage these things to the second decimal point. There will be puts and takes but we look at it in the round. And I think somewhere around the 13.5% level is entirely appropriate for us. We're a little bit above that at the moment and we're fine with that. We may be closer to that in subsequent quarters and I guess we'll be fine with that. I'm not sure I'm answering the question the way you'd like me to, but that's all I'm going to say on it.

Chris Cant, Autonomous

If I could just push you a bit on your observation on the countercyclical buffer implying a buoyant operating environment. I guess firstly, my interpretation of the change is that the Bank of England has just changed their view on the normal through the cycle level – it has nothing to do with the buoyancy or otherwise of the UK economy. They just think that's the long-term average.

And secondly, if it was a buoyant operating environment, in what way does that negate the need to change your capital target when your MDA's just gone up by quite a bit? I'm a bit confused as to how the operating environment feeds into the setting of your capital target. Obviously a buoyant environment would make it easier to increase your capital to a new revised higher target, but I'm a little bit confused as to how philosophically that fits into your process of setting your capital target [...].

Tushar Morzaria

It just means you're more profitable

Chris Cant, Autonomous

Ok, so you could move to a higher capital target then?

Tushar Morzaria

It just means you're more profitable so you're generating more capital each quarter.

Robin Down, HSBC

Can I come back to the very opening question that Alvaro gave you? You're obviously signalling this morning that you expect a meaningful improvement of the ROTE this year, which starting from 9% I guess would probably be pushing up to around 9.5% or so. I'm looking at the consensus today – or the consensus you published pre-results – and it's at 8.5% for 2020. Now I can see some of the gap might be down to actual equity levels being slightly lower than perhaps consensus had forecasted, but to go from an 8.5% to let's say a mid-nines level does suggest some single hundred millions of extra PBT versus the consensus. I'm conscious obviously you're making this forecast very early in the year, which kind of feels quite brave in terms of crystal ball gazing, but what is it you're looking at when you look at the consensus versus your own management budgets and think, well they've got that wrong? And I'm guessing one element is the UK bank levy. I assume the new lower level we've seen in 2019 might stick. But where else is consensus going wrong here, if you like, in your view? Is it the impairment charges? Or is the kind of two percent revenue growth versus one percent cost inflation just not positive enough in terms of jaws? Perhaps if you could give us a good bit of colour it'd be very helpful.

Jes Staley

Having done this for four years, we have been consistent in terms of ROTE [improvement] every year. We delivered 4.4% in 2016, we delivered 6.5%, which is quite a bit above consensus in 2017, 8.5% in 2018. Again, people thought that was a stretch, and then obviously 9% [...] Through the whole course of this year, consensus was pretty much around 8%, 8.1%.

So if we can do in the fifth year what we've done [in the last] four, hopefully we have a meaningful improvement in the 9% level, and well above the 8.5% that the street has for us. I would point to a couple

of things. I just want to say we've moved some £500 million of costs that we're basically using to run the bank to emit £500 million of investments. Whether it's new [trading] algorithms in the investment bank, or moving from monthly to weekly downloads of a new version of our banking app, or the new services that we're putting on that platform, or rolling out the new front office technology for the corporate bank in Europe. Those are all investments that we believe are going to generate revenue, and perhaps we're more optimistic than the street is in the impact of those investments.

We also have been demonstrating our ability to capture market share, particularly in the Banking and Markets businesses. When you improve markedly your prime balances, those are prime balances that are very sticky and they stay and it's very stable income, and we saw that during the course of the year and now we'll have the benefit of that through the entire year.

So obviously we can't predict where markets go, but we're fairly encouraged by that. You also have the other side of the equation where our credit spreads are virtually at all-time tight versus where they were over the last decade, and we do have a one trillion pound balance sheet that we have to fund. If the credit spreads come down, your funding expense also goes down.

Tushar Morzaria

I think that's pretty comprehensive Jes. In some way Robin, it's just maybe a recap on some of the comments I made to Alvaro's question. I do think we're very pleased with the momentum that the business has, whether it's growth in our secured mortgage portfolio, high quality deposits coming in on both the corporate and consumer side, plans we have around transactional banking, improvement in productivity of our corporate lending book. We are really excited about the payments business and expansion into Europe, and being able to offer new products and services there. You know the wealth business we've been investing in, that will improve. I think on the impairment side, we've talked about UK 30-day, 90-day unsecured delinquencies actually trending down a little bit, and stable in US cards.

We've added a new airline in our US cards portfolio, Emirates Airlines, which we announced this morning. We think there's about two million Americans that fly with that already, so it gives us the opportunity to grow that business. There's a multitude of things that we are very excited about.

As Jes said we don't have the crystal ball on the economy, but as we see sitting here now, we think with that momentum in the businesses, with the credit environment that we're in, and the discipline we have around cost we should be able to improve returns from where we were this year. Time will tell how well this year pans out.

Guy Stebbings, Exane BNP Paribas

First of all I want to just come back to Barclays UK NIM, and what sort of assumptions you're making there. Anything that can help us gauge the sub-300 basis points guidance which clearly could imply sizeable downside risk. You've talked about some of the headwinds in terms of rates and mix, but on the other side you've referenced the overdraft fee income changes, which should help here presumably – albeit unhelpful for OI. Perhaps you could size that for us, and whether there's any other offsets for NIM, so as to give us a bit of reassurance that below 300 basis points isn't meaningfully below 300 basis points? And also in terms of mix effects coming through there, looking at asset quality performance it does sort of beg the question whether you might change your strategy here in the future in terms of card growth. That's the first question.

And I just wanted to come back on capital. Just to sort of check my interpretation here is correct – I mean presumably one of the reasons for running with a lower MDA is because the increase in the countercyclical [buffer] would allow you to draw down more on stress test losses in the future, in terms of stress testing. So your implied PRA buffer should be lower, all else equal, even before considering lower conduct losses, which seems likely given PPI, and potentially a favourable provision from the Bank of England on provisions of stage two losses as well. I mean is that a fair assessment or am I missing anything? Thanks.

Tushar Morzaria

Let me do it in the reverse order. It is a fair assessment, and when Chris asked the question I did sort of say we look at capital across a number of lenses, including stress testing, and I suppose our internal stress testing as well as the Bank of England as well as PRA buffers. You've seen on the slide that we put out this morning that the offset that the Bank of England talked about, in terms of Pillar 2 offset to the increase in the countercyclical buffer, does lower our reference rate of passing the stress test, so I think that's a fair interpretation there. But again we look at these things in the round and across a multiple of lenses. It's a fair point.

On the NIM, I think the point I'd want to really emphasise here – this is as much just an expression of the shift in mix in our business, as opposed to just net interest income on a like for like basis coming down. Obviously we have a little bit of a headwind from structural hedges and grinding into slightly lower rates, but putting that to one side, we would expect – all other things being equal – to grow our interest earning balance sheets, mostly driven by mortgages. Now as you know full well that's just a lower margin product with a lower impairment outcome, so a lower sort of mathematically constructed net interest margin. So in the answer to your question Guy, it really depends on how much we grow that mortgage business relative to our unsecured business. I would say that our business is pretty healthy at the moment. You've probably seen various reports on the healthiness of application volumes. We are growing our share of the mortgage market ahead of our current stock share at the moment, which we're very comfortable with. I'll let you form your own opinion on how much that could be. We did about approximately £2 billion, or just a bit less than net £2 billion in the fourth quarter, and £6 billion in the year, to give you a sense of where it could be. But think of it as a mathematical outcome, but we're still trying to drive up our net interest income, all other things being equal, from a higher interest earning balance sheet.

Guy Stebbings, Exane BNP Paribas

Are you able to give any numbers around the changes in overdraft? Fee income and how that moves into NII?

Tushar Morzaria

I don't have them to hand with me here. I'm loath to chuck it out on a call but perhaps if you put in a call with IR later on they may be able to dig something out from our disclosures, rather than me throwing out a public number on a call like this.

Raul Sinha, JP Morgan

I've got a few follow-ups but mainly one on capital. The pension deficit reval which looks like it's about £4 billion benefit to your capital projection for the next few years – how does that impact the stress test performance, and would that help your base stress test plan – base capital plan – going into the stress test? And also does that feed into the Pillar 2A eventually if not the PRA buffer? That's the first one.

The second one is on how should we think about the payout ratio now that you are at your capital target. 38% on a clean basis obviously sounds quite low compared to your peer group. Should we think about an update on what is the right payout ratio at the interims, or would you encourage us to wait until you know the next stress test is out of the way, and we should really think about this as a FY2020 event?

Tushar Morzaria

On the pensions, I think that's right. Obviously our base trajectory has improved just because of the lower deficit reduction contributions. They total about £4 billion over the projected period. Under Pillar 2A it's a little bit more complicated than that. Pillar 2A is essentially trying to capture the level of volatility that you may have in your pension surplus deficit, and more an accounting measure of the surplus deficit rather than the actuarial measure, which is the jumping off point for our triennial [revaluation]. We have been de-risking that pension plan, taking advantage of, if you like, the lower funding deficit. I definitely don't want to speculate on how the PRA may look at that as a Pillar 2A matter, because they'll look at it from multiple, multiple lenses. But on a standalone basis, if you're de-risking the pension plan that ought to be helpful, but there's many other things that go into that.

In terms of payout ratio, it's something that we discuss at the Board quite a lot, and I think we'll talk more about this as the year progresses. I think at the end of the day dividends are important to us. We would expect them to increase over time. We've talked about progression of increase – obviously we have good cover at the moment. And we'll see kind of how much we increase that as the year goes on, and we'll supplement that with variable returns – probably buybacks – as and when appropriate, and we'll talk more about that when the time's right.

Ed Firth, KBW

Can I just bring you back to the debt sales in the UK business? Because I'm not sure I really understand exactly what's driving that and where they come from. Is this a book of debt? Do you have an unrealised gain that you can tell us about? How should we be thinking about this and in what circumstances are they bigger, smaller? Do they come? Do they go? So all those sort of drivers would be my first question.

And then the second one, obviously the wires are full of the investigation from the PRA etc. Could I just ask Jes to give whatever your formal piece is on that as well? Thanks so much.

Tushar Morzaria

On the debt sales, there's nothing new here. This is something I think all banks do as a way of life. Generally speaking when you have a bad debt, there are other businesses that are much more suited to dealing with those bad debts, both as a customer proposition and as an operational matter. So it's just something we do from time to time. It just so happens we did it in the fourth quarter this time round. As a P&L matter these are fully charged off – so these are like fully impaired, if you like. The recovery value in someone else's hands is different to us because they're operationally geared to do this in a way that we wouldn't be able to do. That's how this thing works but there's nothing more to it than that, and they happen all throughout the year. There's nothing particularly magical about them.

Ed Firth, KBW

So it sounds like in a benign environment you generally would get them? It's going to be easier to sell non-performing loans – is that a fair assessment?

Tushar Morzaria

Yes. I guess so. As I say the only thing I want to stress is 2018 had debt sales, 2017 had debt sales, '16... this is something we've been doing for years. There's nothing new about it. It just happened to be clustered in the fourth quarter, that's all.

Ed Firth, KBW

And it's normally around the sort of £100m, £150m level for a year, and you just happened to have it all in the fourth quarter?

Tushar Morzaria

No I don't want to give a number out like that. We haven't got that disclosed, but I think what you're looking at is the fees and commissions line being higher in the fourth quarter compared to previous quarters. A big chunk of that is going to be explained by this, yes, but that's all. I won't say any more than that.

Jes Staley

I think it's very well-known at my time with JP Morgan, at the beginning of 2000, when I started to run the private bank, where he was an existing client, I've had a professional relationship with him for that period. As I left Morgan the relationship began to taper off quite significantly and that stopped before I joined Barclays, and obviously there's been no contact whatsoever since then.

The inquiry by the FCA is very narrowly focused on whether I've been transparent and open with the bank, and I feel very comfortable going back to 2015 I have been transparent and open with the bank. [Per] the RNS, the Board has done a review of that issue and they have confirmed that they're also comfortable that I was transparent and open with them with respect to that relationship. And now the process will just go on at the FCA, but again I had no contact whatsoever with Jeffrey Epstein while I've been here with Barclays.

Fahed Kunwar, Redburn

So I'm coming back to Barclays UK. You talked about the mix effect on secured and unsecured, but if I look at the structural hedge, the net contribution, it came down by £300 million, which is around 15 basis points, which kind of explains the entire reduction in your NIM in Barclays UK.

If I look at the swap rates right now, three month LIBOR is at 75 bps, five year, seven year are at 75 bps as well. So it feels like that's going to zero at the moment. So that £500 million of net hedge contribution is going to zero and it's worth about 25 basis points. Am I right in thinking that that is just going to mechanically roll off if nothing changes in the yield environment? And can I get an understanding of how that would roll off? Because it feels like your starting point is a heck of a lot lower than 300 basis points. And then from there we can think about mix shifts and such like. Is that a fair assumption?

And then just to follow up on the underlying picture I think you said earlier that there has been some margin improvements in the mortgage market. Do you think that's sustainable or do you see competition heating up from here?

And then my second question is on payments. You talk about that being a big opportunity. I think the last time you said it's still loss-making. When can we expect this to start being profitable and what kind of scale of profitability and profits can we expect in the payments business over the next couple of years?

Tushar Morzaria

I'm not sure I'm following your logic that much on the NIM and the the way you're thinking about it. It's probably something we might want to have a chat with you outside this call. But I think if you're saying a jumping off point is 25 basis points lower NIM from where we are today I think that's way too much of a...

Fahed Kunwar, Redburn

Just on the hedge income itself. The £500 million on the front book. If you look at the current yield environment – I'm assuming you're refinancing that at zero – so if that doesn't change that £500 million will just go to zero. Is that incorrect?

Tushar Morzaria

Yes I don't think you've got that right Fahed. We'll give you a call outside of this, but I think you're way off the mark there. The amount of net interest income headwind just from the rate environment staying where it is and cycling through – I think you're maybe overestimating that so we'll point you to the disclosures to help you get to the right one. I think probably just some confusion.

Jes Staley

On the payments side it is very profitable for us. We don't break it out as a segment on its own, but payments courses through a lot of what the bank does, and for sure our merchant acquiring business is quite profitable. Our merchant to supplier payments business is a very big component of our small business banking and corporate banking.

Roughly a third of the GDP of the British economy goes through our payment pipes – both as a bank and also as an acquirer, so they're very profitable and we're investing in payments and what you see happening in the corporate bank in Europe is also part of that. So payments is a profitable part of the bank, we just don't break out the numbers in a segment basis.

Tushar Morzaria

The final question you had was on mortgages and the sustainability. I try not to speculate too much on it. It feels like a good environment at the moment. Application volumes are up. It's easily a three-month delay from applications into actual lending, so we'll see how much of that transits, but at the moment it feels like a reasonable environment and margins are sort of stable. We'll monitor it closely.

Fahed Kunwar, Redburn

Tushar, can I just ask one question on the hedge. Sorry back to that point – so your disclosure on margins you say the structural hedge contribution went from £800 million 2018 to £500 million. That £300 million was just a reduction in NII – am I misunderstanding that and that would've cost you around 15 basis points in margin?

Tushar Morzaria

Yes. Just give me a call after this. I think you're looking at the gross numbers there rather than the...

Fahed Kunwar, Redburn

The gross numbers are £1.7 and £1.8 billion. The net was £0.5 [billion] and 0.8 [billion].

Tushar Morzaria

Fahed, honestly your numbers are way off. Let's give you a call outside of this rather than going on with this for ten minutes. We'll give you a buzz and sort it out. Okay. Thank you everybody for the call. Appreciate your time and no doubt we'll see you on the road over the next few weeks. Thank you very much.

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