Barclays PLC Q1 2018 Results

Sellside Breakfast Q&A transcript (amended in places to improve readability only)

3 May 2018

Tushar Morzaria, Group Finance Director

What was very important for us was that the Group reported a double digit return, I'm ignoring the conduct and litigation line and I'll ignore that line when we talk about returns prospectively as well, because our targets for 2019 and 2020 are struck excluding that line. Although I'm not actually expecting much to go through that line from this point on, but I'll come back to that.

Group RoTE was double digits, which was very pleasing for us, of course Q1 is seasonally strong so we need to just bear that in mind. But also helpful for us, and important for us, is both operating groups were in double digits as well, both the UK businesses and the International businesses. And of course, as you are probably aware, that's been struck at 13% CET1. As our capital ratios have glided upwards, we've obviously allocated the consistent amount of capital to the operating businesses.

Within there of course, Head Office was a negative and, just to remind you, which I think you already know now, but there's really only three recurring items in Head Office. In some ways, all three are transient as well.

You've got the legacy funding instruments, which we mentioned at the full year results, they'll be transient until some of those instruments drop off or we call them, so that will be somewhat straightforward, I think, for you guys to model. The Italian mortgages, which are actually relatively minor in the scheme of things, certainly as a P&L matter, and the unwind of hedge accounting, which actually relates to consumer businesses that we sold as part of Non-Core, and it's the rolling off of the hedge accounting. Hedge accounting is obviously quite a complicated area and, in some situations, hedge accounting gets recycled to P&L actually on disposal of the group, in other situations, if it's a portfolio hedge accounting relationship, then it just recycles through over the original term of those hedges, and that's what you are seeing there.

The only other item in Head Office, and it's really the last time you'll see it, is the net residual of our Group treasury operations, and that oscillates plus or minus, but will be zero over any trend basis. The reason why that's the last time you'll see it in Head Office is, now that we've set up Barclays UK and Barclays International as legal vehicles and are running the company on a fully ring-fenced basis, the treasury operations of the Group are actually devolved inside the entities, so there will be no Head Office residual treasury operations, that will all actually be within the businesses themselves.

So on a prospective basis, legacy funding instruments, Italian mortgages which is very, very small and the unwind of the hedge accounting relationships. The only other thing that will go through Head Office, and it's not going to be one that you'll be able to forecast, just so you don't get surprised as and when it may come through, you saw a bit of this in Q1, to the extent that there are any legacy conduct and litigation items, we'll roll them through Head Office. RMBS, for example, went through Head Office.

And sometimes, it doesn't necessarily appear on the conduct and litigation line, sometimes it may be on the other income line or something like that, but that's the only other thing that will go through Head Office. So it's not something you'll be able to forecast. To the extent we have visibility over it, we'll obviously give you as much notice as we can. But as I say, I'm not really expecting much of that at all from this point on.

Other points to highlight, we are pleased with our Markets performance, it's probably our second quarter running that it feels like, on a currency-neutral basis, our revenues outpaced our peers, so playing a little bit of catch-up from underperforming our peers for the first three quarters of 2017. But it's pleasing for us that it's the second quarter that we seem to have done a bit better than our peers.

And actually Banking as well, we don't talk so much about that, but our Banking fee share increased sequential quarters. It was our second best Investment Banking fee quarter and the best one was actually the first quarter of 2017, so we feel pretty good with that business. We continue to be the number one fee earner in the UK, as we were in the full year of 2017.

And in BUK, underlying income was flat and there was a small gain this time last year, as a result of the sale of Visa shares, and in these [Q118] numbers, there was a slight negative for some remediation that was to do with CCA3 and that goes through negative income. It's a non-recurring item, not so significant that we would call it out, but anyway it's a non-recurring item.

And NIM was 327 basis points, towards the upper end of our guidance, and we'll talk more about NIM, I imagine, through the Q&A. Where we go from here is a little bit of a function of what happens next Thursday and beyond in terms of Monetary Policy Committee actions.

Something that probably doesn't interest you guys so much, but does interest us a lot in the firm, and we are proud of this, is that we have set up a UK ring-fenced bank, we were the first UK bank to do so. The reason why it's such a big deal for us, it's an enormous undertaking, you know how much this has cost us and how many people were involved on this. For that to go through relatively seamlessly, to have the ratings agreed with the rating agencies, funding capital, financial resources all approved and the High Court approving the ring-fencing scheme is tremendous work by a lot of folks inside the company. So although it isn't probably as much from your perspective, it's a tremendous achievement.

Other points to just call out. Capital ratio at 12.7% for Common Equity Tier one. We're still expecting to need to be at around 13%, obviously there'll be PRA stress testing that will probably inform a forward view of PRA buffers. We'll also have Pillar 2A updates that normally come through over the latter half of this year. So there will be some ebb and flows no doubt, but I still think in the round we're going to have to be holding somewhere around 13%. So 30-or-so basis points of accretion from here, which feels quite reasonable for us, organic profits generated 30 basis points of capital in Q118.

Just the other point on capital, is we did reaffirm our intention, again subject to the usual approvals, to pay a dividend of 6.5 pence and we're hopeful that now that we have some of our more significant conduct items behind us, that's an easier journey for us.

And final comment is just on targets, they remain unchanged, both the cost targets for next year, but also the returns objectives, but just to remind you, our tangible book value has come down quite significantly as a result of various non-recurring items, whether it's the RMBS settlement, IFRS 9, etc. When we set our returns target objective, it was struck off a higher tangible book and we would expect tangible to grow from here, all things being equal in terms of currencies and interest rates and what have you.

But certainly when I look at adjusting items, below the line items that are meaningfully negative to tangible book, there's not much I see on the horizon, so I would expect, all things being equal, tangible book to appreciate from here and grow, net of any distributions back to shareholders.

Claire Kane, Credit Suisse

On the legacy instruments, the run rate at the moment is £360m and I know you mentioned the RCIs, but can we assume the residual instruments are the 2018 maturity ones? And therefore by the time we get to 2020, actually all of that is gone.

Tushar Morzaria

It's not a bad assumption, you've got the dollar prefs in there, we've been clear that's got a quarterly call, so I'll be surprised if that's around in 2020.

Claire Kane

But the prefs won't be in the expense line, won't they be in the preference share line?

Tushar Morzaria

Yes, you're right, that's in the NCI line. But you've got the RCIs, I don't think we have detailed the other ones, but just thinking out loud, by 2020, it's a fair assumption that these are largely gone.

Claire Kane

And then my second question is, when you back out some of the remediation costs in the UK and then the funding benefit that you put through the businesses, NIM on a combined basis, and even in the UK and International is flat to down in the quarter, and I know you did mention that you thought UK NIM would go down after Q417. But given the pricing has probably been a bit better than most banks expected, and Q1 is typically a nice quarter for refinancing, and we heard about the delta you expect on funding spreads, I was just a bit surprised that it wasn't up in the quarter. So maybe you could just talk about the trends there.

Tushar Morzaria

Yes, in Q4, you may recall, there was actually a slight gain as a result of our treasury operations that flattered the headline reported NIMs, but if you strip that out and compare, if you like, an underlying NIM sequential quarters, it was roughly flat in fact.

The point around margin pressure is a good one, I'm not sure we saw much margin pressure relief during Q1, but certainly round about the close of the quarter and into early Q218, as the Term Funding Scheme has rolled off, a lot of commentators were wondering whether this would result in mortgage spreads widening.

And they have eased slightly, so the pressure's eased off, and we have seen some better pricing and we'll see how that continues. So in some ways, that's helpful to mortgage NIM, which is obviously a big driver of it. The other thing that will be important, and probably not much will happen until next Thursday, but if we do get a rate rise with liability pricing and how that flows through and that's a little bit harder to call now.

But we have seen, over the ISA season, some quite competitive pricing for some ISA products. So there may be those that are looking for other sources of funding away from the Term Funding Scheme, maybe that's an early sign of some action, but it's probably too early I think, you'll have to wait till next Thursday to see if there any real material movement in liability pricing. But that wouldn't surprise me.

Michael Helsby, Bank of America Merrill Lynch

I've got two questions and just a request. If something's big enough for you to call out in terms of the trends, can you just give us what the numbers are, that would be really, really helpful.

So firstly on IFRS 9, I was wondering if you could tell us what the sensitivity of the UK bad debt charges is to movements in GDP, given the weakness in trend.

And, secondly, on the CIB business, I was wondering if you could tell us what the total funding benefit was in the quarter from moving it out, so not just the Markets piece. And within Equities, I was wondering if you could tell us how much of the improvement was from you extending leverage, i.e. the investments in the prime business, from a balance sheet point of view, and how much of it was just market volatility in trading.

Tushar Morzaria

Okay, so noted on trying to give you the numbers, so we'll take that on board and we'll do that where we can.

IFRS 9 sensitivity, it's a very good question and I imagine IFRS 9 will be a topic for several quarters as we, both you guys and even bank management, get more used to exactly how this will behave over the cycle.

I won't quote sensitivity, as we haven't given sensitivities out, even in a transition document or in our first quarter release, so I won't do that here. But in terms of trying to be helpful to you, at least as we saw it in our scenarios, we didn't see any improvement or deterioration in the UK as a macro matter. And therefore the credit impairment numbers for Barclays UK were, if you like, really just driven by underlying credit conditions and book size etc.

We did see an improvement in US conditions though, and the way we try and think about this is not to be overly precise, so if we see macroeconomic data moves every single quarter, you get a lot of false positives. Remember a lot of these things get revised one quarter later, and so we try and wait until we've got real conviction that there's a proper change in macro conditions.

In the US, we did feel that on the back of the tax changes that went through, in the way we source consensus of economic forecasts, it felt much more like a conviction call, rather than a minor revision. So that flowed through across CC&P and CIB. The CIB business, as you're also aware, had a number of one-time recoveries that are probably non-recurring.

But if you strip that out and the economy in the US doesn't change our macro view of forecast changes in economic conditions, and you wouldn't expect the one-time recoveries to reoccur, or if they do they'll be one time again so not something to forecast I don't think, I think you'd go back to really a relatively small impairment bill, assuming there are no recoveries, which you may have seen in previous quarters.

And I don't think you'd expect us to do significant revisions on macro forecasting every single quarter, it's only if there's a real conviction behind that, so a permanent change. And it's quite complicated giving the sensitivities, because actually what happened in the US, to give you a little bit more colour, it was actually downside scenarios that impacted our impairment numbers more than the baseline and the upside scenarios, so this is all quite complicated now.

So not only do you run a baseline macroeconomic forecast, you then have to say, this is my baseline on a probability weighted basis, what downside could I experience and what upside could I experience and you put that into your model. And for us, it was actually the less seriousness of the downside that contributed to the improvement in the impairment provision.

These are quite tricky and I think, over time, when things have gone through two or three reporting periods, I think that's probably the right time to start giving you more helpful sensitivities, so that you can take your own view of how these things may move.

Michael Helsby

And will you disclose those?

Tushar Morzaria

I think we will do over time. I think you'll see more disclosures, probably from all the UK banks, at the interims. I think Q1 was very light and it's the first quarter we're all doing this. And the other thing with this is, of course just trying to be helpful in the disclosures, there is a risk that we end up disclosing things that are not particularly informative for you to forecast off. So we'll try and be as helpful as we can, but it's quite tricky, because when you ask for a sensitivity, we've got to figure out what's the best number to give you so you can project.

And even if you really want to dig into what that was, it was really house prices, that's probably the more important parameter than even GDP, so quite complicated stuff.

Moving on to CIB and funding, yes you're right, we called out Markets, we didn't call out the rest so I probably won't disclose it here. But it's sort of evenly spread, you could probably get a sense of the size of the balance sheets, you could probably evenly spread, that's probably the best way to think about it.

Equities and leverage: The businesses that performed well in the first quarter were prime and equity derivatives, both contributed to the pick-up in revenues. Leverage was definitely a helper in equity prime and we did deploy leverage in fixed income prime as well. We saw that fixed income price spreads were really competitive, there's a lot of leverage being deployed in the fixed income space. So while it was helpful, the profitability in equity prime was the more attractive place to deploy leverage so that definitely was helpful for us.

And then equity derivatives, it wasn't significant position taking as such, we had a relatively defensive stance going into Q118, so you have the right type of inventory so that when prime orders come through, bid offers widen out, and when markets get choppier, you can fill a lot more of those orders, as we were somewhat defensively positioned going in there. And that was a very profitable trading quarter for us, as it was for many banks to be honest, I don't think we were super unique. We did a bit better than some of our peers, but everybody had a relatively good equity trading quarter.

Michael Helsby

Could you give an idea of macro with prime, was it 50/50, was it 25% prime?

Tushar Morzaria

Calling them both out probably gives you a sense, so assume that they're both important in contributing, yes.

Andrew Coombs, Citi

A couple of questions on the Consumer, Cards and Payments result. If I look at US cards net receivables, that's down quarter on quarter, I think the income from that division as a whole was the lowest since Q216. You were obviously up against an FX headwind there, but it does look like US cards has gone backwards, underlying. It looks like your margin is coming down. I assume that's due to this repositioning towards a lower risk mix, but if you could just elaborate on how much further that has to play out, because you've obviously previously guided to 10% growth in the receivables in that business?

I'm just trying to get a feel for what is the growth trajectory, what's the margin trajectory, and then more broadly I'd love to know a bit more about how the economics work in the co-branding deals as well.

Tushar Morzaria

So you're right, the FX headwind had an impact, and this time last year we sold about £1.6bn of receivables, so that's what was quite a meaningful part of the book. If you take out the FX component, take out the assets sales, underlying receivables, on a dollar basis, were up about 10%. I appreciate it's a little bit hard to see that and there are obviously a couple of other smaller businesses in that line as well.

So the growth still feels pretty good to us, and the books like JetBlue, are contributing well, all the airlines are actually doing quite well, whether it's Hawaiian, Alaskan, Frontier, JetBlue and American, they're all doing quite well. The other important thing about that book is about 70% of those partnerships have now been signed up again until I think at least 2022, so there's not much of the book that comes through for renewal.

And in many cases, in fact the last one that came up for renewal, it wasn't even RFP'd, it was a straightforward renewal. But that gives us a bit more visibility and we like that cohort of customers, but we'll need to manage credit carefully as we get longer and longer into a cycle. But the US still feels quite constructive.

In terms of NIM, you're right, obviously there's a very high yielding part of the portfolio that we sold that will naturally have an impact on the lower reported NIM. But we look at it very much on a risk-adjusted basis, and we're pretty pleased we got that part of the book out. We looked at the charge off rate in that part of the book that we sold, and it was getting close to 20%, so though we would have had a higher income, higher NIM, it would have had a hell of an impairment impact to us as well. So I'm glad we did that.

I think you will expect us to, where we can, continue pruning of risk we don't like so much. In our own branded portfolio, Barclaycard, because it's a relatively young business, you can still pick up spectrums of FICO scores that you're not entirely comfortable with, so expect us to continue to do some sensible risk management, as and when that's required.

So to the extent we do that again, and I'm not forecasting anything in the near-term, but further out, to the extent we do that, we'll try and give you exactly what it was worth and what it contributed, so you can see what the underlying basis is.

The economics of these businesses, that in itself is quite a complicated subject, all the contracts can be somewhat bespoke, it's very much a revenue sharing type concept. We are the underwriter, the credit decisions all lay with us, obviously if we're turning away lots and lots of customers from the retailer, that is going to cause a problem, but actually there's no contractual enforceability of the retailer forcing us to take credit we're not comfortable with. So we have, if you like, the throttle on how much to produce and that really results in the revenue share stat.

But you've got to be a little bit careful when you bring on a new book, like Uber was quite an interesting thing it turns out, and Uber is a tricky portfolio because it's such a broad spectrum of underlying credit, I think 60 million downloads of the app in the US, I don't know how many of them are live users, but tens of millions. Generally speaking, on a more mature book, like the airlines books, it's relatively straightforward and it's just a revenue sharing agreement.

But it's locked in for a long time, so what then happens is, of course, if you underwrite credit and you start impairing it, that impairment problem is really ours because the revenue share kicks in. That's why these things have got to be priced, the revenue sharing mechanism has got to be very careful that you can take yourself through the down part of the cycle and still feel your returns are appropriate.

Andrew Coombs

And to your point about 70% now being signed up until 2022, I can clearly see why that's a positive in terms of the visibility. In the past, what you've had play out is, the growth has been subdued in the run up to the RFP and then it's picked up again. But given that everything's now all signed up, presumably there's no such lumpiness there.

Tushar Morzaria

Yes, and the one where we really saw a lot of that was the American Airlines portfolio, it's such a large part of our portfolio, the rest, in and of themselves, wouldn't jump out, but the dynamics are exactly that. We're coming into RFP in September, we're focused on the RFP, rather than originating credit for credit's sake, but you wouldn't see that from this point on.

Tom Rayner, Exane BNP Paribas

Firstly, on CIB, Jes on the results call talked about the cost: income ratio in the first quarter as indicating scale and that you're now able to compete. So my impression was he's pretty happy with the cost position of all the businesses within there and I guess my question is, how can we be sure there's not cost subsidisation going on still between maybe the Corporate business and the Investment Bank, because obviously Q1 is a very good revenue quarter, maybe more so this time than normal. I think market risk-weighted assets went up more than Markets revenue did in the first quarter as well. So if we had enough disclosure, we could actually work out the returns across those two different businesses. Would we be comfortable that there isn't cross-subsidisation going on?

And second question is on the Cards business. You mentioned that the book you sold, the lower quality and how the charge offs had deteriorated, I'm just trying to get a sense that you're not concerned that that might be a precursor to a more generalised deterioration in US credit quality.

Tushar Morzaria

On the cost: income ratio in CIB, we were pleased with the performance and decent jaws in that business and of course, if you look at the way compensation has accrued now that we've, as you will recall back in 2016, unwound the deferred compensation arrangements that we had in the company that led to relatively inflexible accounting in the year in which those performance awards are granted, it is flexible now.

So you would expect us to accrue more compensation in line with the better performance in Q1, and that was inside those cost numbers. And even with that, you saw what we thought were quite reasonable jaws, so we were pleased with the performance there.

Structurally, the cost: income ratio in the Corporate Bank becomes more of a continuum now, so we don't really have something that stands in itself and calls itself the Corporate Bank and does its own thing and the Investment Bank does its own thing. Alistair, who was running our UK Corporate broking business, is now running the entire coverage machine around the corporate banking spectrum, both for investment banking lending and regular corporate lending.

Alistair Currie, who runs the product management across all products as well, more the infrastructure and platform. But nonetheless, they're different businesses, obviously the corporate finance, capital markets, advisory, is a much more of a human capital business than it is a product infrastructure development business, so you'd expect a higher cost: income ratio. The Markets business would have a lower cost: income ratio than the Corporate Finance business, those are more heavy in intellectual capital and less heavier in bank capital and infrastructure, just has those dynamics.

So we don't really think about it as a form of cross-subsidisation, they're just different dynamics businesses and manage it to the aggregate. We felt, with the capacity to take more compensation, that was a reasonable cost performance for us.

Cards, it is a good question and, as I say, we sold that part of the book and we may do something like that again in the future sometime. That's not really a statement of our overall concern in US credit. But as you've seen in the US, through various channels, whether it's subprime, auto loans and various things like that, the low end of that spectrum of credit has exhibited stress. It's not something we're particularly skilled at managing, it's not what we want to be managing, so to the extent we see parts of that in our portfolio, mostly through our branded card business, because we're quite young into that, then we will look to try and move that along if we can.

But broadly speaking, the US consumer credit environment remains pretty constructive and, in fact, with the tax changes that went into the macroeconomic forecasts in our models, we're probably more constructive, but vigilant on it. This is the rate tightening cycle and policy errors are possible, so we need to be quite nimble and careful here, which is why we do like the big airline portfolios a lot and they tend to be the better credit quality, slightly lower margins of course, you just have to price that in margin, but they do tend to be relatively better credit quality anyway, and the bulk of our book is really tied up with the airlines now.

Joe Hopkins, Morgan Stanley

I've got some questions on litigation. Firstly, have you had any more clarity on the SFO case? And on PPI, due to our increased provisions in the quarter, what are you currently seeing in terms of volumes and should we expect that figure to increase?

Tushar Morzaria

SFO, there is not much I can say on that, because there's reporting restrictions. It's the way UK law works. There were some court proceedings actually going on last week and the week before. Anybody can actually go to those court proceedings. You could have gone and sat in court and some reporters do, but under UK law, you can't actually report on what happens. So I can't give you the summary of what was said, you'd have to go to the courtroom yourself to hear it, unfortunately.

We'll see what the judge decides. If it does go to trial, then the trial will be sometime towards the middle to back end of 2019. If the executives are not convicted, then there is no culpability for the bank. If the executives are convicted, there may be culpability to the bank, but not much more I can say than that.

PPI: We have £1.7bn in reserves, we have 17 months to go. We've been running at about £90m a month, so it gives us about two months of contingency. That £90m a month picks up the very elevated claims that have happened around the marketing campaign. It also picks up some payments we were making that, if you like, isn't flow inbound, it was remediation of old stuff, but it gives us a little bit more contingency as well. So, it feels pretty adequate and pretty prudent. If that was regular extrapolation, I think, you'd be extremely comfortable with that, we've got quite a bit in the tank, but even if claims were to step up again, and stay stepped up for a period of time, we would have adequate provisions.

The thing that's very hard to model is any pull forward. If you're sitting here in July of 2019 and all of a sudden there's a deluge of people that decide to lodge their claim, then it's an impossible thing to model. Even if that were to happen, we obviously have some months of contingency in our provision. If it's more than that contingency then there may be a revision, and if it's less than that contingency, then we'll have a release, but at the moment, it feels pretty adequate.

And we're the kind of bank that doesn't top up as frequently as perhaps some others, and when we do, it tends to be of a larger quantum. Last time we topped up was Q217, so I wouldn't expect us to be talking much about PPI. If you look at the historical pace at which we tend to revise the provision, it's not that frequent, and hopefully, we're not revising it anymore. We feel we've got enough.

James Invine, Société Générale

A couple more on the US card business, please. We can see your overall credit card market share, but was just wondering what your share is in just partnership cards, if you have a number for that. And then for your branded card book, how many of those cards are going to your existing partnership customers?

Tushar Morzaria

Our existing brand book is really small. I think it'd be in basis points if we gave market share on our Barclays branded portfolio, and it's not something that's a core part of what we're trying to do. We want to grow as a partnership but our overall business, dominated by the partnership book, is about 2% of the US credit card market. So, even if you're growing at 10% or something like that, we're still relatively small in that market, and that's why we feel confident that you can grow at those quite interesting growth rates and still don't feel like you're doing anything that's dangerous. And we'll grow it through growth through production and winning contracts.

And there, pricing becomes really important, so if we're not successful in growing at 10%, it may well be that we just don't like the pricing of certain contracts and that probably is a good call by us. But all things being equal, we've been able to win enough contracts over a trend basis that we think 10% is a realistic objective for us. And we feel more constructive on the US economy than we do in the UK, so we're comfortable growing on secured credit there in a way that we're not really in the UK, where we haven't grown unsecured credit, probably for two years now.

James Invine

Do you have a number for the market share for the partnership book?

Tushar Morzaria

So I don't know off the top of my head but, I think, something like close to 80% of the book is parrtnership, and we're talking about 2% of the overall credit card market is dominated by our partnership business. I don't know what the overall sale of the US or the partnership, but we're relatively small. For example, take the Costco deal that Citi won. We would have to raise capital to win the Costco deal. It's almost the entire size of our book. An Amazon book would be an enormous thing for us, so we're relatively modest, even though we've got some nice headline accounts, like Apple, NFL, the airlines and various other things, we're relatively modest in the scheme of things, we're not in the same scale as an Amex or a Citi or someone like that.

Ian Gordon, Investec

Firstly, just going back to RWAs within CIB, you talked about it on the call, you reaffirmed your total guidance, you talked about reallocations in the quarter. How much further scope do you see for reallocations between the business units to optimise returns in that business and where?

And, secondly, just going back to the US prefs, obviously I don't expect you to tell me when you're going to call it, but in terms of your optionality, do you regard it as something where you need to reach 13% plus a margin to do it, or are you happy to contemplate it on the way through towards 13%?

Tushar Morzaria

On the RWAs, we've made very good progress, I'd say we're probably a bit more than halfway through, and this is really looking at opportunities to recycle capital currently committed in our corporate lending book that we don't see any opportunity to reprice or get ancillary business to make those returns work and then to redeploy that elsewhere in the CIB. And it can go to a multitude of areas, we're one of the lead underwriters on the Sprint deal earlier this week and that's a great use of capital for us, it's faster velocity, very high returns, or it could be somewhere else. It is marginal capital gone to find the best place it can. We're a little bit more than halfway through. And I've said this before, we have been somewhat pleasantly surprised with the number of large corporations that are actually prepared to either reprice or give us ancillary business. It's not the whole suite of them, obviously, but probably more than we might have thought. So this is the best sort of answer out of everything, because it's a nice annuity business with a decent return, we like that.

The dollar prefs, I wouldn't say that capital needs to be over 13% before we do anything like that. We've been calling these dollar prefs along the way at much lower capital, I think it's more about just pacing it and the trajectory of capital and just trying to be sensible with our deployment of capital to accrete earnings. We'll do it when the timing feels right and it's obviously very apt to do that. It's, obviously, got a little bit more expensive over the last week or so because the Pound's weak, although we like a weaker Pound generally.

Al Alevizakos, HSBC

Going back to US credit cards, I was intrigued when you mentioned Costco actually. I was just wondering, given the proposed changes that the Fed has asked for the CCAR test and, of course, given the main kind of concern that you would have on the CCAR test would be the stress testing on the US credit cards, does that mean that now you've got more available capital that you could potentially use there to underwrite more business in the US credit card business? And if so, how much would it be, in terms of real capital and how would this be translated into the receivables?

Tushar Morzaria

It's a good question in a sense that I do think that there's some potential for CCAR to be less onerous than, perhaps, it is. I don't see that anytime soon, unfortunately, we've got the new framework that's out there in stress capital buffers, we stress it through CCAR, they tell us what their number is and, of course, if their number's bigger than ours, we'll take their number, now they're just going to tell us what the number is. So, I think, we'll need to find our way through that. I think, at the margin, it feels slightly beneficial but, I think, we'd have to go through a cycle to really understand that.

In terms of the risk weighting, so in terms of capital to receivables, it's quite a high risk-weighted business, but very underleveraged and actually, probably for CCAR, we're as much Tier 1 leveraged. We can manage that carefully as we need to do for CET1, so probably the real benefit for the Cards business is possibly on Tier 1 leverage. And so it sits very nicely against the broker dealer, which is a much more leveraged business in the IHC.

Al Alevizakos

You do not believe that, actually, the Fed will completely remove the Tier 1 leverage? Because that's, basically, the proposal.

Tushar Morzaria

It is, so it's a wait and see. I'm always very circumspect on these things. You get some nice surprises. I think, US taxes was kind of a nice surprise and then there was this anti-avoidance tax provision that caught everybody off guard and all of a sudden, we're all running around trying to work out what that means for us. As our Chairman said at our AGM, count the money when it's in the till.

Chris Cant, Autonomous

On US cards and CCAR in particular, Capital One recently said they were going to increase their capital targets because of concerns around CCAR getting worse rather than better, at least in the short term, and it doesn't sound like you're optimistic about things getting better in the short term. So I'm just wondering, how do you think about the distribution of capital within the non-ring-fenced entity between the IHC and the rest of the business, please? Should we expect the non-IHC, non-ring-fenced bit of the bank, to be less well capitalised within International?

And then coming back to your RoTE targets, obviously, you allocated 13%. You've said that you managed the Group to 13%. When I think about how some of your peers report divisional ROTEs, for instance, RBS, they do use very different capital allocations for the different businesses to reflect capital consumption. It does look to me like your Investment Bank is not getting the right tangible equity allocation, based on the leverage balance sheet that you're applying there. And, obviously, you've added more leverage capacity and said that you can do that without any additional capital precisely because you're, effectively, relying on the diversification from the US cards. So, when you come down to the desk level, do you allocate capital on the same basis or do you allocate capital on a different basis, taking into account leverage constraints?

Tushar Morzaria

On the first one, at the moment, we don't anticipate the IHC requiring any more capital than it has, but I'd put a gigantic caveat on that. Obviously, CCAR will be the governor on that and its successor, SCB, as it's going to be called. So no, but I think we'd have to wait and see how we perform through this round of CCAR to see whether there's any adjustment required to that, but we feel as though we can withstand the numeric stress comfortably, but you never really know until the Fed gives us their view of the numbers and so more to come on that.

It's a good question on capital allocation and we've kept it somewhat simple for now, in terms of just allocating both to the UK business and those in the International businesses of 13% risk-weighted assets. Of course, we now have legal vehicles in place and so, I think, you'll see us move over time to allocate capital on the stack within each legal vehicle, and there'll be slightly different drivers to those stacks. I don't think the actual overall capital requirements will be that dissimilar but, obviously, the drivers of the requirements will be quite different. We are definitely minded that because things are in a legal vehicle, to optimise the use of capital within that legal vehicle. For example, in the IHC, it's very helpful for us in the IHC, to have a broker dealer and a credit card business alongside each other because they have quite different capital characteristics and that's quite an efficient combination.

In terms of going down to the desk level though, and that is a good point, we have a unit in the Investment Bank that, if you like, literally does allocate capital. The capital that we give to the Investment Bank is allocated down into very granular activities. And that's a very sophisticated allocation of capital that does take into account leverage consumption, as well as risk-weighted asset consumption, as well as stress capital, which, in many ways, I think, will ultimately be the binding constraint for us. Even though it's something that's a periodic one-time exercise, you can see the stress capital, and the consequence of that, probably drive as much overall capital punch as anything else.

Chris Cant

In terms of how those two things fit together though, in a world where currently, I think, your IHC is probably going to be better capitalised than BBPLC as a whole, how does the UK regulator then think about the capital distribution within that entity? Because, obviously, the US regulator, in a stress scenario, will, basically say, right, that capital is mine and the UK regulator will be left with what's left over in the rest of the business really.

So, would they be comfortable with that diversification argument? Because ultimately, the Cards is sat within the IHC, not the rest of the non ring-fenced entity, so the remaining business doesn't benefit from that leverage diversification if you like, and then will look, potentially, over-levered in the eyes of the UK regulator.

Tushar Morzaria

So what the UK regulator does, and as we get into a post ring-fenced world you'll see a lot more of it, there's a unique regime in the UK, I haven't found another country that has it, but they look at the capital of the regulated vehicle, excluding its subsidiaries, something that's called solo. And so, if you do have a bank that owns many subsidiaries and capital is pushed into those subsidiaries, then they'll assess the capital adequacy of the parent bank in isolation, assuming no support from its subsidiaries. Can it withstand its prudential requirements? And that's something we've lived with forever, so that's not a new concept in the UK and our various banking operations have always been designed to ensure that the solo regime can be managed adequately as well.

So, it's something that the UK regulator has been very, very focused on forever, which is not true of, say, European or Swiss or even US regulators. In there, you can actually push a lot of capital down to another subsidiary and your domestic host regulator will accept that as good capital, even though it may be trapped in the event of a resolution, but not so in the UK, so we're, I would say, probably more sophisticated as a UK regime than other regimes.

Robert Sage, Macquarie

I've got a fairly detailed question that follows from some of those that went earlier. It's about margins. And you're showing, among other places, on slide 27, the margin of Barclays UK and then Barclays International. And the International number that you quoted, 457 basis points, is a very significant step up from the first quarter of 2017, but is also usefully higher than anything else we've seen in terms of the last five quarters.

I'm very cognisant that you're deliberately reallocating capital into higher margin business. But most of it has obviously come through on CIB, because, as you've said, the CC&P margin is down. And I was just looking at the quantification of this 457 basis points and wondering, is this likely to be a very volatile number, going forwards? Or is it actually something that you think probably is sustainable broadly, going forwards? Or are there any one-off items within it? Or how should I think about that?

Tushar Morzaria

Not so much one-off items, but there's probably two real components in there. One is the optimisation of the corporate lending portfolio and potentially reducing that corporate lending portfolio a little bit further. So lower margin business coming out, if you look at our blended margin, may continue to improve that blended margin. Against which, I've mentioned that to the extent that we have opportunities to prune some risk in the Cards portfolio for low-end credit, which is very high margin, typically, I think that would have an impact on margins as well.

So it will bounce around a little bit, but those are the two competing forces. And once we're in a steady state, then perhaps it'll be something that'll settle down and you can have an easier look through, quarter by quarter. That probably is the first two things I'd guide you to. And I think, over time, once it does steady down, we'll probably try and disclose a little bit more detail behind it, make it a bit easier for you guys to project that out.

Ed Firth, KBW

One question is about your cost: income target. Because your IB is now knocking out a 63% cost: income ratio, and you're only targeting below 60% for the Group as a whole, which implies you're imagining somewhere around mid-50s for the rest of the Group. And yet, most retail and commercial banks, really anywhere in the world, are looking well below 50%. So it doesn't seem to be a hugely demanding target. So I guess the question is, when you say below 60%, that obviously could be anywhere, it's a big barn door. But how should we think about that in terms of how far below 60% you can go?

Then a slightly related question. Within the IB, could you just tell us what the comp ratio is and how that has varied over perhaps, I don't know, the last couple of years?

Tushar Morzaria

Yes. So comp ratio is really only best looked at on a full-year basis. And I don't have the disclosures with me, but I'm sure IR can just give you the page that gives those comp ratios for last year and the year before, etc. We don't disclose on a quarterly basis, so again, I won't throw out a number here. But you'll see the full year comp ratio. And just to let you know, you'd expect in a good quarter like the first quarter, to be over-accruing relative to the full year average.

Edward Firth

So you'd expect the comp ratio in the first quarter to be higher than the full year?

Tushar Morzaria

Not necessarily higher but more comp. If you're thinking about cost profile, more comp Pounds are booked in the first quarter.

Edward Firth

But in terms of cost, the comp element of the cost: income ratio.

Tushar Morzaria

So we haven't disclosed this so I'm not going to throw a number out. So no further comments because we haven't disclosed that.

But comp Pounds is the only thing I can guide you to, more in this quarter than you'd expect in the others.

Edward Firth

Could you think about disclosing that going forward, though? Because it's obviously very helpful in terms of trying to get a sense what the steady state business is.

Tushar Morzaria

Yes, noted. I understand why you'd want to see that, so let's have a think about that.

Cost: income target, yes, and how much of a stretch target. I think everything that we've set out there, I don't think we should necessarily think of these as resting points. These are way points or milestones. So let's get to below 60%, and then let's reassess where we go from there. Just like returns target – let's get to 9%, let's get to 10%, and let's reassess where we go from there.

When we look at some of the big, large US universals, those that have a similar-ish business mix to us, probably even are slightly more diversified than us, have a larger asset management business and things like that, for example, and remember, their scale is a quantum different from where we are, they seem to be in the 55%, 56%, 57% cost: income ratio, and they're probably at much more of a cruising altitude and post-restructuring and post a whole bunch of stuff.

So I think anything below 60%, in today's money, starts getting you, on our measures at least, to the top quartile, in terms of our peer set. And we're coming at it from a slightly different angle, with probably less scale advantage than they do have, certainly in the wholesale side. And we probably have more infrastructure investment to do still than perhaps they necessarily do, maybe they've done though in the past, I don't know. But think of them as milestones rather than anything else.

In the UK bank, again, think of that as a milestone. Sub-50% I think is an objective for us that we have out there and we want to get to that. That doesn't mean it's going to be 49.9%. I have no doubt in my mind we'll continue to drive it lower. But rather than throwing out a number like 45% when we're at 56%, you have to give yourself more tangible, meaningful objectives so you can assess how well we're doing against them.

Raul Sinha, JP Morgan

Can I have maybe two, please, just on capital and stress testing? On your Pillar 3 disclosures, obviously you disclose a fully loaded CET1, including a fully loaded adjustment for IFRS 9. And obviously, the gap between that and your reported number is 50 basis points at the headline level, 12.2% versus 12.7%. So I was just wondering, is there anything else? Is that just rounding? And how does the UK regulator look at that, at all, I would've thought, given they've made it pretty clear they don't want IFRS to distort capital requirements? 12.7% is the number for the stress testing. That's the first one.

On the second one, do you have any thoughts on your hurdle rate for this year's stress test? It looks, to me at least, that it could be north of 7%. And if that is the case, then it invalidates your entire stack of AT1 really in terms of stress testing. So, if that is the case, would you reconsider perhaps some of the strategy around AT1, given it's pretty dilutive to equity shareholders?

Tushar Morzaria

For IFRS 9, yes, that's just rounding. It's actually rounded on both sides, unfortunately, so it's in the 40bps range. It's 38bps, I think, in our transition document, but it's ticked up a little bit. It's a good point though. It's not the ratio that we're going to be primarily managing and it's certainly not the ratios that the regulators primarily expect us to comply with. I don't think the fully loaded ratio will have any implications to how the PRA will look at dividend approvals. I don't think it will have any significant impact on how they'll look at stress test outcomes. Again, I guess we'll see, but that's certainly my going-in assumption.

And then the other thing I would say is, it's a slightly peculiar number because, assuming there was no transitional framework at all, it's the full effect of having to book IFRS 9 against your capital stack on day one. Of course, if you have a transitional effect, it is on that number because, the amount of deferred tax assets you'd include improves as well. So when you cycle it through, it's a lower number, in fact. But I know you guys have modelled that and you're aware of that. So it's a slightly peculiar number, it's not, in that sense, a real number. The real effect of phasing in will be lower than that.

But it's not something that's primarily managed, or we're told to primarily manage, by regulators. And I think the Bank of England have been very good about that in terms of the FPC's comments and the PRA's comments around stress testing for this time round, and not having significant accounting moves necessarily interfere with bank capital. So we take our cues from the regulator in that regard. And regulators have been very transparent and straightforward in the past. When they wanted to go fully loaded, we were left in no doubt that Basel III gets fully loaded immediately, and deal with it. But this one, we're certainly not getting that cue.

Hurdle rate on stress test. No real comment on that in the sense that it's actually quite difficult because Pillar 2A will now be variable, and various other things, so it's quite hard to quantify. There is a minimum amount of AT1 we do need to hold. To the extent that AT1 becomes less and less relevant, yes, you'd expect us to optimise that capital stack. But probably one for a post stress test conversation.

David Lock, Deutsche Bank

Barclays Capital Securities Limited, you filed the accounts for that. And I think for the first time, you gave us a Pillar 2A for a subsidiary, which was only 0.88%. Is there a change in your disclosures, going forward? Are you going to be giving Pillar 2As for the different little subsidiaries of Barclays, going forward?

Tushar Morzaria

Yes, so it is the beginning of the new, post-ring-fenced regime. You're going to see Barclays UK, you're going to see Barclays International, you're going to see the IHC, you're going to see Barclays Capital Securities Limited, you're going to see where our Smart Investor business is booked, in something called Barclays Investor Services Limited. But, the short answer is yes, you're going to get a lot more prudential disclosures because of the post ring-fencing disclosure requirements.

David Lock

And to be clear, each of those subsidiaries has its own Pillar 2A requirements?

Tushar Morzaria

And on the Group as well.

David Lock

And they should all add up to the Group?

Tushar Morzaria

Yes, absolutely. In fact, and I actually even don't know, off the top of my head, exactly what the mandatory requirements are of disclosing what at what level, but there will be more than you've seen before, that's for sure.

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