

Barclays PLC FY 2022 Results**Fixed Income Conference Call Q&A Transcript****(amended in places to improve accuracy and readability)****15 February 2023****Lee Street, Citi**

Firstly, there was a bit of a fall in RWAs in Q422. Any comments on how you might expect RWAs to evolve over the course of 2023?

Secondly, you highlighted the healthy position of the pension fund at the moment. Have you given any consideration or is there any scope to do some form of buyout to effectively remove future risk at all? Is that possible?

Anna Cross, Group Finance Director

I'll take the first part of that, and then I'll hand over to Dan for the pension part.

Q4 was somewhat of a low point in terms of RWAs. There's a few things going on in there. We clearly saw an FX move in the quarter. We also called out the reduction that we took in terms of our leveraged finance portfolio, and actually Markets activity more broadly was pretty low going into the end of the quarter.

Conversely, Q1 tends to be our seasonal high point of RWAs, so you are going to see us lean into that opportunity and put some RWAs to work in the Markets business over the next quarter. We called that out in our results, and that's why we've been really thoughtful about getting to the midpoint as a proforma in terms of capital.

Beyond that, we will pursue growth opportunities as we see them, but would do so in a really disciplined way that you've seen us grow US cards. Each business is actually generating a strong rate of capital for itself, but we're also mindful of the macroeconomic environment. We haven't seen any procyclicality yet, but we are very much looking out for it, so I'd expect to see us grow back to a Q1 peak thereafter. I would see probably more balance growth across the portfolio, but just mindful of the environment.

Dan Fairclough, Group Treasurer

I'll pick up the second question. Look, we're always considering options, but the principal strategy here is one of de-risking. This has been a multi-year journey since structural reform. We've been working with the trustees to de-risk the pension fund position. This involved de-risking the asset composition, matching it better against liabilities. You'd also note in the Annual Report, we've also undertaken longevity hedging to further reduce the risk. So I think we would expect to continue that strategy of de-risking to ensure that the pension fund does not have a material impact on us going forward.

Rob Smalley, UBS

Some questions around credit cards both in the UK and US. I see that stage two for the US is up a little bit, and stage two for the UK is down over the past couple of years. Could you talk about your methodology for moving cards from stage one to stage two? One of your competitors did some of that on a discretionary basis, so if I could get a little background on your methodology there.

Then number two, where do you see this going over the next year given economic slowdown? And three, if in fact you're saying you're not seeing much deterioration so far, are there other types of statistics or financials that we should be looking at that'll give us a better clue on what's gonna happen with the consumer portfolios through 2023?

Anna Cross, Group Finance Director

The two books are performing in different ways, and in large part, it's because customer sentiment is different in the two economies. So what we see in the US is that customers [are] more confident, more inclined to borrow. That's obviously been added to by the fact that we've onboarded the Gap book, so we've got organic growth and then we've got growth from Gap.

Now, when we contrast behavior to pre-pandemic, although it started to normalise, it's still really quite different. Repayment rates on cards remain high, and although we've seen delinquency rates tick up a little, they are still below what we would have expected to see pre-pandemic. So there's nothing there of concern, what we see is some stage migration, but let me describe to you how that can happen.

Firstly, purely by using your card and by purchasing more, there is a possibility that you would move from stage one to stage two, because the more you use your credit card, clearly that will drive up your probability of default. It might not indicate that you are going to default, but it will have moved in absolute terms, so a movement in stages is exactly what we expect to see when customers start spending money again.

The second thing I would say is that, as we onboarded Gap, it was all onboarded at stage one. That's merely what the accounting rules require us to do. And then what happens over time is those customers settle into the stage that we would expect them to be in for the longer term. So you've got both those impacts going on in the US.

The opposite is true in the UK, because whilst customers are spending more, they're not borrowing more, and that's merely - I think - because of the UK outlook, certainly from a media perspective is bleaker. Therefore, what they are doing is they are repaying at levels that are even higher than during COVID-19. We've actually seen our interest earning lending balances in the UK fall, so you've got the opposite effect going on in the UK, but the methodology applied to both books is the same.

To some extent it's not a surprise because these books were constructed to absorb affordability stress, both in terms of our secured and unsecured lending. Because when we extend credit to someone, we extensively stress test their affordability. Then if you think about the fact that levels of indebtedness across both economies are actually materially lower than they were pre-COVID, and then add to that the fact that unemployment remains very low in both economies, it shouldn't really surprise us that what is clearly affordability stress is not translating through to credit stress, and we really can't see that anywhere. Arrears levels are very low and stable in the UK, whilst in the US they've ticked up a little, but below pre-pandemic level.

The last thing I'd say is that our coverage in both US cards and UK cards is high. For US cards, it's 8.1% overall, and stage two balances are covered by 33%. We believe that that's probably elevated relative to

our peer set. In the UK, [it's] 7.6% overall and nearly 20% on stage two. So even if the economy does turn, and you should probably note that our macroeconomic variables that we've used in the fourth quarter [deteriorated] from those used in the third quarter. Even if it does turn, we feel that we have got good robust provisions to cover that eventuality.

Rob Smalley, UBS

That's, very helpful. If I could follow up on one thing, given the high repayment rates on UK cards, how does that translate into the net interest margin (NIM)? Can you quantify how many lost basis points of NIM you have as a result of the high repayment rates?

Anna Cross, Group Finance Director

It has definitely impacted our NIM and we talked about that a little bit on the equity call this morning. We haven't disclosed that, but you can see quarter on quarter what's happening to our Barclaycard income, but you can also see the other side of that in impairment. So at this point in time, whilst we really would like our UK cards book to grow, we're pretty happy with the trade off between those two things. I think the lead indicators for card growth are definitely there, but we're going to have to see consumer sentiment change before we see meaningful growth in interest earning lending.

Paul Fenner-Leitao, Société Générale

You've talked about what's going on in the credit card business. You've talked about deposits not really moving, and these are kind of some forward indicators. One of the things either you or someone else mentioned over the last six months is what's going on in the use of debit cards and consumer behaviour. What are you seeing there that indicates what might happen to stage two over the course of the year? Any kind of indicators of some early signs of stress? Asset quality is the big bogeyman out there, and it's just extraordinary that there's no kind of early signs of [deterioration]. I'd just love a little bit of color on that.

And then the other question is on CRE, what [are you] seeing there? Any color you can give on your book and any danger signs?

Anna Cross, Group Finance Director

We have access to a considerable amount of data, not just through credit and debit card, but also obviously through our Barclaycard payments business. What we see is customers acting really rationally, so that they are moving their spending towards essential spending. So we see less on what we would regard as non-essential spending, but that spending is pretty much holding up.

Interestingly, they're still keen to travel, which may count as essential or non-essential depending on your point of view, but we are seeing customers react in a way that shows that they are managing their affordability pressure in a very rational way. That hasn't really changed to be honest, it's very very consistent as we exit last year and indeed come into this year.

Dan Fairclough, Group Treasurer

We [also] spend a lot of time looking at deposits, particularly saving deposits and breaking that down by demographics, socio-economic, deposit sizes, and just looking at that as an indicator of any early signs of consumer distress. So obviously one of the early things that people will do is run down savings, and as we said in the script, we're not seeing it materially, but I think that's a pretty good lead indicator at an individual level.

Anna Cross, Group Finance Director

As it relates to CRE, we've given some disclosure on CRE in the quarter. You can see that our exposure has fallen a little, and actually we've managed our UK exposure pretty flat for a number of years now. The level of stage three assets within CRE is very low. You can see that in our disclosures under the focus sectors, and actually we would say that the LTV profile across the whole portfolio is low. It's well collateralized, and our perspective is that any stress scenario can be covered.

As you might imagine, at this point in the market, we are very focused on ensuring that we have up-to-date valuations on this portfolio, which we are doing regularly. You'll see that we note it under our selected sectors area, that means essentially that it's attracting additional management focus. It doesn't mean to say that we are seeing significant impairment in there, it just means that we know that that sector is under pressure. You can see overall it's a very low proportion of Group loans. It's around 4%, so we're broadly happy with it.

The last thing I would say is that, as we run our impairment scenarios for all of our portfolios and particularly CRE, we're obviously looking forward to a slightly deteriorated outlook. In the CRE portfolios, we're actually running some quite significant reductions in CRE valuations as part of those scenarios. That still doesn't give us cause for concern given the nature of the book.

Dan David, Autonomous

I've got three. The first one is just on issuance plans. If you could provide a bit more detail on types, whether you'd still expect to be a majority Dollar issuer? And maybe you could just talk about covered bonds and how covered bond issuance might evolve with TFSME rolling off in the coming years?

The second one is just on the unswapped assets in the liquidity pool. Interested in a bit more colour on that, whether it was a strategy to optimise income given the market or if it was operational? And if so, what's being done to resolve?

Finally, favorite topic of legacy. Interested on your Discos, whether there's been any change to the classification or the way that you view them after the EBA's letter to DNB? I'm thinking about the early tax call. And then just on those with regard to LIBOR, do you intend to use the synthetic dollar LIBOR extension after June cessation?

Dan Fairclough, Group Treasurer

In terms of issuance plans, we've said that we are going to do c.£10bn. We've got that left to do. We'll be active across all of the tiers, as we said in the script. We will obviously be somewhat opportunistic in terms of currency, which will be driven by market demand and pricing, but given the depth of the Dollar market, I think we should expect that we continue to be a big issuer in the Dollar market. It does provide the depth and confidence of execution for us.

You had a question on covered bonds. We obviously issued a cover bond this year. We run a very significant liquidity surplus in the UK, so it's not something we will do very frequently, but we will maintain some name in the market and we'll look at it periodically. TFSME repayment is not a particularly big driver of our liquidity position, particularly given the size of surplus that we run.

I think the second question was about unswapped assets in the liquidity pool. So the vast majority of assets in the liquidity pool is held as cash with central banks - it's [78%] or so of the total liquidity pool. There's a portion that is held in securities. A lot of that is on an asset swap basis, and a very small proportion of it will be actively managed from a fixed rate perspective. That portion obviously will

contribute both to net interest margin, but will also contribute to trading income. We manage it holistically and it generates positive returns overall. Your last question was on the Discos, could you just repeat the question again?

Dan David, Autonomous

Yes, we saw a letter from the EBA with regard to DNB's Discos, and they were quite explicit on the way that they viewed a couple of points. And I guess what came out of that was that they should have declassified them earlier than they had done. I think you guys still call them Tier 2 until June-25, so I'm just wondering if there's a change in that view, given what the EBA said? I know it's EBA versus Bank of England. And then secondly just on synthetic LIBOR, whether you intend to use synthetic LIBOR as an extension post June this year?

Dan Fairclough, Group Treasurer

Yes, we're watching the DNB and EBA debate with interest. Obviously we're not governed by the EBA. There's no equivalent guidance from the PRA, and we've been consistent in our treatment for some time with these instruments as Tier 2.

In terms of synthetic LIBOR, I think it's a little bit too early to say anything here, given it's still under consultation. We expect that probably not to resolve until into Q2, so nothing further to add on that at the moment.

Dan David, Autonomous

Thanks. Just on the first question, you kind of touched on LCR. Just quickly, do you have a target LCR? I know it's elevated at the moment, do you have a number for the longer term where you'd look to manage towards?

Dan Fairclough, Group Treasurer

Not particularly. Obviously we've got risk limits that ensure we're always prudent to regulatory minimums. Therefore, the remaining output of the LCR is largely due to balance sheet strategy and mixture of assets and liabilities. We are very focused on making sure that the liability base is as economic and commercial as possible, so we do routinely go through and ensure that the funding mix and cost is in the right place, but I wouldn't call out a specific LCR target.

Ellie Dan, Morgan Stanley

I wanted to ask another legacy question, this time about the legacy Tier 1 preference shares. I understand these are now grandfathered as Tier 2 capital until June-25, but because they're subordinated debt at the OpCo, I guess it doesn't count towards MREL. How are you thinking about these and whether it makes sense to leave these outstanding?

Dan Fairclough, Group Treasurer

I won't comment on individual securities. I think we've said before that key for us in our consideration in this area is the treatment as regulatory capital, because that's obviously what provides the Bank of England stabilization power. So that's really the key cornerstone of our philosophy here.

Daniel Crowe, Goldman Sachs

A first one on the surplus on the pension. I know there are some changes in how the regulator is looking at that in Pillar 2, but is there some scope to see a potential reduction there?

And then just another one on synthetic LIBOR? I was just wondering if you'd looked at the potential impacts on the assets and the liability side, or do you have an idea of how much might be affected, given that we could have a potential end to that?

And then just a third one if I may, as I had to drop off the call this morning, I think I got a semi-partial answer there earlier. What was the other 33bps impact in the Barclays UK NIM?

Dan Fairclough, Group Treasurer

Last year, we called out that we expected a benefit in the Pillar 2 calculation from the de-risking of the pension position. That has occurred, and we have had a reduction in Pillar 2A. Unfortunately that has been offset by the change of calculation in the way that the PRA determines the Pillar 2A number. So over the COVID era, they allowed that to dynamically move with RWAs. They've now reverted back to fixing that on a periodic basis against RWAs. So the two things have largely offset in the overall number, but we have had the benefit in terms of the pension de-risking point.

In terms of synthetic LIBOR, we are still focusing on reducing the LIBOR exposures that we've got, and we're focusing on that on the assets and the liability side. That's an ongoing journey, so it's a combination of both the final consultation on synthetic LIBOR and what we are left with in terms of that journey, but we think we're actively working it down.

Anna Cross, Group Finance Director

Of that 33 basis points, it's broadly half and half between product impacts and the Treasury impacts, which Dan just reflected upon. So the product impact, we're seeing some compression in mortgage margins. In part because of the nature of the market, very low loan to value, low margin product out there and a lot of churn, and also a reduction in interest earning lending for cards as I mentioned before. Although there's some offset to that within the impairment line. We have not yet seen significant liability migration, but that's something we might expect to see in the future.

What Dan referred to you before was some securities held in the BUK liquidity buffer in fixed rate form. The cost of funding those clearly spiked a bit in the fourth quarter, and therefore we've seen the margin on those compress. But as he said, it's a short term impact, because they tend to be short-dated and they are actively managed, so that part of it we expect to dissipate over time.

Daniel Crowe, Goldman Sachs

Thanks. Just on the dissipating over time, what sort of duration are we talking about? Is that one year or?

Dan Fairclough, Group Treasurer

Significantly less than that. We would expect this to be significantly moved in the early part of the year.

Tom Jenkins, Jefferies

Just on the new issuance calendar this year, which you've highlighted for MREL of c.£10bn. Should we just assume that it'll be following or tracking much along the lines of your redemption schedule? So for example, you've got an AT1 coming up in September, I think [around \$2.0-\$2.5bn]. Should that be our guiding light as it were? Or should we be thinking about it in a different way in terms of the makeup of your c.£10bn?

Dan Fairclough, Group Treasurer

We'll never comment on upcoming calls for obvious reasons. I think to be honest what we did last year is a pretty good guide as well in terms of the type of mix and shape that you would expect of our issuance.

Robert Montague, Allspring Global Investments

Regarding your capital and your MDA hurdle, which is currently 11.3%, and as you point out, will go up to about 11.7% at the start of Q3 with the further re-introduction of the UK countercyclical buffer. Your CET1 is currently 13.9%, but obviously you've got some headwinds in Q1, which takes you to around 13.5%. So by my reckoning, your MDA buffer will be about 180bps, I'm just wondering if you think that's sufficient? Also you've got a target of 13-14%, and given that your MDA hurdle would go up to 11.7%, whether you would up the lower bound?

Dan Fairclough, Group Treasurer

We've designed our long-standing capital target with this in mind. This increase in the countercyclical buffer has been in the wings for some time, so we're very comfortable with the range. I'll probably make a couple of points in terms of why we're comfortable.

Firstly, we've operated with that range in the past. Secondly, we're obviously highly capital generative, so 150bps of CET1 accretion, and that's the >10% RoTE target, that provides us with quite significant room to maneuver in terms of the the buffer. Thirdly, the expectation would be, as has been evidenced, that in the event we did hit a macro stress, we would expect the regulator to reduce the CCyB. So for all those reasons, I think we're comfortable even after the introduction of the CCyB to operate in the target capital range.

James Hyde, PGIM

On leveraged lending, I always try and find what the exposure is and I can't. Commitments down 50% since H122, can we at all scale this? Initially I thought it would have something to do with that £54bn corporate lending exposures, first loss [protection on] 32% of these loans, and on the earlier call it sounded like you said these are predominantly for leveraged lending. Did I mishear that? Can you scale it or can you help me in any other way?

Anna Cross, Group Finance Director

The £54bn that relates to the first loss protection is actually corporate lending, so not leveraged lending. We haven't disclosed our leveraged exposure. We have clearly disclosed that we've reduced it by 50% over the last two quarters, that's reflective of the wider environment. We are operating well within our risk limits, and we've taken appropriate marks at the end of the quarter.

The other thing I would say is that we do obviously hedge these exposures as well. We use tail hedges and the costs of those is going through the corporate lending line. So when we talk about marks, we're talking about net marks. It's an important business for us, and we feel like we are well-positioned in it given the the risk decisions we've made.

James Hyde, PGIM

This time you don't seem to have called out [the impact] as three-digit millions, which you had done in previous quarters, is that fair?

Anna Cross, Group Finance Director

Yes, so over the year, I think the net marks are actually c.£335m, and it's about c.£85m in the fourth quarter.

James Hyde, PGIM

That's very helpful. Thank you very much.

Anna Cross, Group Finance Director

It looks like there are no more questions. Thank you for joining the call today. Really appreciate your time, and we will see you in meetings over the coming weeks.

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