Barclays: business-as-usual under the spotlight

Scope's debut ratings on Barclays' ring-fenced bank and holding company came on 8 May amid a barrage of news highlighting that while the group can lay to rest certain legacy issues, management is far from being able to focus squarely on the current iteration of business-as-usual.

Following changes to the group's legal structure to implement UK ring-fencing, Scope affirmed the A+ Issuer Rating of Barclays Bank PLC and assigned first-time A+ Issuer Ratings to Barclays PLC and to Barclays Bank UK PLC. The rating report was updated on 25 May.

The ratings are driven by Barclays' progress in adapting its business model to a changing operating environment (sell-down of Barclays Africa, balanced revenue profile, smaller and refocused investment bank); early closure of the non-core unit; successful establishment of ring-fenced bank; track record in strengthening group capital, liquidity and funding; and resolution of material legal and conduct issues.

On the latter point, the UK Crown Court recently dismissed charges brought by the UK's Serious Fraud Office related to alleged fraud over the bank's fundraising with Qatar during the financial crisis. UK regulators had not long before published their final notices relating to the CEO's whistleblowing infraction (breach of Individual Conduct Rule 2: requirement to act with due skill, care and diligence), and the bank settled its civil action with the US Department of Justice related to underwriting and issuance of RMBS between 2005 and 2007.

New sources of uncertainty

But new uncertainties have emerged: activist investor Sherborne Investors, which acquired a 5.2% stake in the bank in February, is reported to be finalising its strategic blueprint for the bank. This has consumed the attentions of the media sphere and the sell-side analyst community. As has chatter that Barclays may have had a hypothetical conversation about merging with Standard Chartered. Both potentially call into question the longevity of the current strategy.

"Barclays has been through years of restructuring, refocusing, and redefining what they would like to be. Moving into the emerging markets that Standard Chartered is involved in represents a huge departure from the strategy Barclays has been pursuing," said Pauline Lambert, executive director, financial institutions at Scope Ratings.

"Management has been resolutely focused on meeting the cost and return targets they've set so they can start paying a dividend again. To go off on such a tangent would be surprising and we would question the rationale behind it. As for Sherborne's intervention, a vocal activist clearly puts pressure on management to justify its strategy in a clear and convincing manner."

Assessing credit at group level

Beyond the news flow, Lambert notes that while ring-fencing was conceived primarily for the benefit of retail depositors; from a credit perspective and for investors, group fundamentals are critical insofar as the UK banks affected by ring-fencing will continue to be regulated and supervised as groups.

Clearly, ring-fencing does not mean that banks cannot fail. Not does it mean a ring-fenced entity will be viewed in a more positive light by resolution authorities. "What regulators are trying to do is make the ring-fenced entity resilient and make sure it's not taking excessive risk that would push it down the path of failure. That's one aspect," said Lambert.

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"The other aspect is the UK regulator believes in the single point of entry in resolution. Any losses that happen at the operating company level would be up-streamed to the holding company. We cannot assume that one operating company would be treated preferentially."

On a business level, Barclays does need to improve its profitability. "We have a certain level of confidence that this will happen as the group is at the tail end of its restructuring and some of the costs incurred in recent years to achieve restructuring targets and to fund litigation reserves are disappearing. We should have a better view of the group's underlying performance," Lambert said.

There has been some focus on the additional hiring within the investment bank. "It is our understanding that management has not increased the overall capital allocated but has shifted resources within the corporate and investment banking division," Lambert said. Management has been clear that the group needs a balanced mix of consumer and wholesale businesses, which are complementary and offer good diversification.

As UK banks implement ring-fencing requirements, Scope will be updating its views on the various UK banks which are affected.

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