ENGAGEMENT CASE STUDY:

# Barclays

Federated Hermes SDG Engagement High Yield Credit Fund, **Q2 2020**

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Barclays plc is the holding company of Barclays Bank plc, a systemically important UK-based bank with sizeable international operations. Barclays is a major global financial-services firm that provides personal banking, credit cards (Barclaycard), corporate and investment banking and wealth and investment-management services. It has an extensive presence in Europe, the Americas and Asia Pacific, with an increasing focus on the UK and US. Founded in 1690, Barclays traces its origins to two goldsmith bankers in London. In 1736, James Barclay joined as a partner and the company's name and London headquarters have remained the same ever since.[1] Barclays employs 80,800[2] people and delivers services in 41 countries.[3]

## Investment case

Barclays is one the UK's market-leading banks, with strong franchises across retail, business and corporate banking. The group focuses on the UK and US markets, which make up one half and a third of the group's revenues respectively. Barclays also has a strong risk-management framework, shown by its relatively low annual cost of risk, although this will be put to the test this year. The bank has a conservative liquidity position of £237bn, a strong liquidity-coverage ratio of 155% and access to liquidity facilities from central banks across the world. Unlike other UK-based banks, Barclays has adopted a bondholder-friendly approach to exercising the call options on its debt, which we see as a key differentiating factor. Barclays also has an above-target common-equity tier one (CET1) ratio of 13.1%. Our analysts have covered Barclays since 2004 and engaged with it since 2011 and note its good track record of managing regulatory ratios (mostly CET1 and total capital ratios) through volatile earnings periods.

## Engagement context

Banks face pressure from diverse stakeholders beyond their traditional investor bases. Apart from the challenge of shifting regulatory requirements, there is an evolving set of expectations from society and shareholders on the role that banks such as Barclays should play in society. Banks are high-quality job creators and systemic financiers of value creation and consumer and business activity, and also face pressure to manage their social and environmental impacts.

Climate change presents a systemic, unpredictable and potentially disruptive long-term financial risk to diversified banks. Due to the critical role that financing plays in intensive greenhouse-gas emitting sectors, it has become an acute point of focus for investors, campaigners, policymakers and swaths of the banking public. But climate action also presents a remarkable opportunity for banks that seek to finance consumer, business and value-chain decarbonisation and contribute to an orderly long-term transition to lower-emission economies that are compatible with the Paris Agreement and national and international climate-action frameworks.

Expectations for the social purpose of financial-service firms are also evolving. The sector provides a critical service to the real economy and there is a recognition that banks must articulate, deliver and quantify social value creation and improve diversity and equality. Globally, around 2bn people do not have access to finance, or lack financial literacy or digital tools, which is an opportunity and a challenge to the sector's social licence to operate. Beyond basic services which may reduce inequalities, banks have the opportunity at regional and community levels to build or partner with others to create bespoke strategies for inclusive financing and lending. These should include measurable outcomes that focus on reducing socioeconomic inequality, creating resilient local infrastructure or helping to grow small-and-medium enterprises (SMEs).

Banks also have a direct impact through job creation and skills development, and in some regions play an outsized role in offering high-quality jobs. Banks need to proactively and meaningfully tackle corporate-culture weaknesses, gender and ethnic-diversity gaps in the workforce and investments in current and future employee skillsets. We believe that banks that do not comprehensively address these issues may face heightened retention and reputational risks, avoidable human and intellectual capital depreciation and reduced competitiveness.

## SDG-focused engagement

The drivers of our SDG-aligned engagement with the company, and our objectives, are described below:

### Financing global climate action
SDG 13

The world is at a critical juncture on climate change. We strongly support climate action from firms that are willing to make commitments and invest in goals and strategies which transform value chains. For banks, this means financing the transition to a low-carbon economy while avoiding disruptive long-term risks. The Paris Agreement, which calls for financial flows to be aligned to low-carbon development, demonstrated the emerging political consensus on the risks of climate change (and was publicly endorsed by many banks). For the banking sector, the deployment of capital through financing, loans and asset ownership must be based on a precise understanding of where the risks and opportunities of the climate transition are. For banks like Barclays, this has serious ramifications for the long-term cashflows generated by financing assets and activities and is most acute in carbon-intensive energy sectors.

### From commitment to decarbonisation

Through our long-standing engagement with Barclays, we seek to ensure it is run in the interests of long-term investors and that it plays a role in building a more sustainable banking system by focusing on financing solutions that deliver a positive social and environmental impact. We set an objective for Barclays to develop a strategy and lending policies to reduce its exposure to parts of the energy sector that are not aligned with the goals of the Paris Agreement, and which present long-term risks to the bank and society. We then intensively engaged the bank, its Chair, company secretary and senior management team on its climate-change strategy, and also involved all members of the Institutional Investors Group on Climate Change. We were heartened by the bank's climate-policy announcement ahead of its 2020 annual general meeting, although we acknowledge that the bank is behind where we would like it to be. Barclays asked its shareholders to vote on its ambition to become a net-zero emissions bank by 2050 and on a commitment to align all of its financing activities to the goals and timelines of the Paris Agreement.[4] This alignment will start with the energy and power sectors and will eventually extend to its entire portfolio. We were delighted to learn that over 99% of shareholders supported the management's proposed strategy and ambition in 2020. Our next phase of engagement will focus on how Barclays will execute and deliver against its strategic intent.

### Purposeful socioeconomic lending
SDG 10, 11 & 17

Providing socially inclusive, purpose-driven financing is an emerging imperative for banks but turning this into meaningful action is a complex challenge. Barclays has an opportunity to provide capital that helps create positive socio-economic outcomes. In the UK, this includes community and low-carbon infrastructure financing, home energy-efficiency retrofits and loans or trade financing for low-carbon SME business models which create next-generation jobs. These examples can deliver tangible benefits to the people and communities Barclays relies on for its turnover. While there are considerable national and international efforts to codify frameworks for classifying whether a loan or asset is truly sustainable and socially inclusive, we share the frustration of banks about a lack of progress in this area.

### Evolving a meaningful approach

Barclays measures the value of its socially inclusive or 'green' financing offerings and products, which grew by 45% to £7.8bn in 2019. Its social and environmental financing portfolio was worth £34.8bn in 2019 (almost 70% of this is considered social). This is part of its focus on "making growth green, sustainable and inclusive"[5] and it aims to reach £150bn in cumulative social and environmental financing.[6] In its 2019 ESG report, the bank acknowledged the lack of industry-wide frameworks for green-finance definitions. This would help the bank clarify its own reporting[7] and remains a weakness across the sector. We believe that Barclays has an opportunity to sharpen its own definition of what these commercial strategies entail and to show how it has sought opportunities to provide a measurable impact. The bank has reported its progress in contributing to Sustainable Development Goals 3, 4, 7, 9 and 11, but indicates that "as better information becomes available, [it] will refine methodologies in order to provide more granular insights".[8] In addition to reporting its purpose-driven financing as a share of its total commercial operations, Barclays could encourage the banking sector to create robust, comparable and transparent standards and benchmarks for these activities.

## Structural challenges in gender and ethnicity equality
SDG 5 & 10

The legacy of the global financial crisis means that banks now face intense scrutiny on corporate cultures and their ability to avoid undue or unethical risk-taking. More recently, the focus has shifted to how wider values and norms are embedded in activities and acted on. Barclays will face pressure to ensure that its workforce reflects the population of the countries it operates in and may be asked to advocate for structural changes in public policy. Improving the equality of employee pay and talent progression is also a way to engage employees and improve productivity and the retention of diverse talent. As the workforce can represent the largest cost for financial-services firms, Barclay's ability to engage, retain and improve social outcomes for employees is crucial to its long-term competitiveness. Finally, regulatory scrutiny – such as the UK's 2018 gender pay gap disclosure – could formalise these pressures. It is likely that fast action on gender and ethnicity pay-gap disclosures will be required, particularly given the recent anti-racism protests in the US and elsewhere.

## Values-led culture development over the long term

We have engaged with Barclays on human capital management and corporate culture since the bank was involved in the 2012 LIBOR scandal. Our dialogue with the Chair and management team originally focused on creating a conduct framework, which sought to combat non-compliant or unethical risk-taking and which could be embedded into the culture of operational and strategic decision-making. Over the last few years, we have been impressed by the progress in embedding a 'values-based' culture across the bank, such as through dashboards which monitor cultural attributes across the firm. We will continue to pursue an objective for Barclays to solidify a culture which is responsible, customer-centric and aligned to stakeholders. For our part, this also means looking at where gender and ethnic diversity is lacking and actions the bank can take to remedy this. This could demonstrate to stakeholders that it is committed to implementing the structural changes required to combat gender and racial inequality and set an example to the whole sector.

[1] 'Our history', published by by Barclays. https://home.barclays/who-we-are/our-history/

[2] 'Barclays PLC Annual Report 2019', p.82, published by Barclays in February 2020.

[3] 'Barclays PLC Country Snapshot 2019', p.1, published by Barclays in February 2020.

[4] "Barclays PLC 2020 Annual General Meeting (AGM)', published by Barclays on 7 May 2020.

[5] 'Making growth "green", sustainable and inclusive', published by Barclays.

[6] 'Barclays PLC Environmental Social Governance Report 2019', p.22, published by Barclays on 30 March 2020.

[7] Ibid.

[8] Ibid.

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