
BANKS ON THE BRINK
Interview of BBC business editor Robert Peston with
John Varley, group chief executive of Barclays Bank

Q: John Varley, you run one of the world's biggest banks, Barclays. There was this extraordinary week in early October when it looked as though almost no bank in the entire world could be absolutely confident that it was you know going to make it to the next day. I mean I'm slightly exaggerating but the, the pressures on a number of big banks finding it almost impossible to roll over their short-term borrowings were extraordinary. How did it feel to be in the eye of what in some senses must have felt like the perfect storm for the banking industry?

VARLEY: Well I think to be clear you are overstating it a bit. It was a bad week but it wasn't quite as bad as you depict. But what was clear was that confidence in the system was, was suffering very badly. It was the circumstances were as extreme as anything that I can remember and if I put it in context, it seemed increasingly likely as the week went on that one or two of the British banks would not be capable of opening for business the following week, and it doesn't get much more extreme than that. And as you know the government stepped and took action, and came to a decision about a system-wide remediation that I think was very helpful for the regeneration of confidence. But it was a, it was a surreal week because the markets were extremely skittish, the media was very extreme in its commentary and it was a challenging week for all stakeholders of banks and indeed the employees of banks.

Q: I mean the two banks in question were Royal Bank of Scotland and HBOS. Do you think that their vulnerability was irrational or you know were the markets behaving irrationally in, in the way that they were finding it difficult to raise money or were they actually fundamentally weak?

VARLEY: Well I'm not going to make a comment least of all on Panorama about our competitors. It wouldn't be appropriate for me to do so. But what is clear is that there was a crisis in the market that week and it had to be addressed because what you couldn't have was any big bank being in a position where it wasn't capable of opening for business. That, the systemic consequences of that would have been too awful to contemplate and I think it was, the week was symbolic in the following way which was that up to that point, I mean over the preceding twelve months, put it like that, a lot of what had gone on in the United Kingdom and elsewhere around the world was what I would think of as national firefighting. Individual bush fires broke out and they were doused by the, by the authorities.

What was very clear in that week in October was that something much more system-wide, much more generic needed to be applied both in the United Kingdom and elsewhere, and market-wide solutions were put in place in that, in that week in October

and since then and I think actually, actually it's been very positive for the world because it seems to me as though the, the national firefighting forces have now been overtaken by the international fire brigade and the international fire brigade I think is doing quite a good job in managing banking systemic risk.

Q: I suppose what I meant to be clear when I said that no bank was safe, you know I've identified two banks that were particularly vulnerable. If either of those had gone down, the implications for other banks in the UK and elsewhere would have been devastating. So it's not as though banks are in a sense discrete entities. I think that's why I sort of –

VARLEY: Well I would agree that one of the impacts of globalisation is that the, the systemic risk within the financial services industry has grown, I mean for sure. And therefore you would certainly have knock-on, knock-on implications in a national market like the United Kingdom if a big bank had failed, and similarly you would have had knock-on implications right across the global financial services system, so action assuredly had to be taken and I think particularly for, for depositors, particularly for people who are not operating in the financial services industry, our customers in other words. It was a week of considerable anxiety and confusion as they saw what was unfolding.

Q: In terms of what triggered this escalation of a problem that had been going on for some months, do you date, would you date it to the collapse of Lehman Brothers, the failure of the US treasury to rescue Lehman?

VARLEY: I think it would be wrong simply to ascribe that, that as the catalyst or to describe that as the catalyst but in a year-long flow of events, clearly the demise of Lehmans was a very big generator of sentiment, and adverse sentiment is what I mean by that. So I think that you can trace a significantly heightened level of anxiety to the failure of Lehmans. That would be true. Whether it was the catalyst of the particular crisis that we saw unfold in October, I think I would be more sceptical about that.

Q: So at what point in this saga did it become clear to you personally that individual firefighting wasn't doing the trick, that what was required was something more comprehensive?

VARLEY: I think it was fairly clear at the end of September. There was such a downward shift in sentiment. There was such nervousness in the markets and we had seen earlier in the year that where, where central banks had taken concerted action it had had quite a significant impact and I think one of the, one of the very positive features of the last two or three months is that the heads of resolution, if I can describe it in that way, the way in which the banking crisis has been tackled has had increasing elements of consistency to it and I think that's been good for the steady improvement, I don't overstate it but the steady improvement in sentiment that we've seen in November and December.

Q: And at what stage did you become hopeful – and then I suppose confident – that you would see a comprehensive package of help from the government?

VARLEY: I think it was very obvious during, during the week. The week that I'm talking about is the week that began 5th 6th October and it was clear during the course of that week as a result of announcements that the government made on the Wednesday of that week, then the work over the weekend of the 11th and 12th of October, and then the announcements that were made by the banks and the government on the 13th of October, it was very clear that a very, we were into a different phase of the financial crisis and that system-wide action was now being taken and it's had a, it's had a good impact.

Q: And if you look back to the mid-week all night session where the framework of the package was agreed, did you think to yourself at that stage these are the right pillars?

VARLEY: Yes I mean the government was, was aiming at the targets of liquidity and funding and capital, and it's very clear to me that those are the right targets for it to have aimed at and there was a lot of dialogue that was going on between the members of the tripartite authorities here in the United Kingdom and the banks, and I felt that, that those targets were well selected, and that if the missiles were fired briskly enough and in sufficient size, then they would, they would do the trick and I believe that they substantially have.

Q: And were you personally at the treasury for most of that particular night, that mid-week night?

VARLEY: The Tuesday night?

Q: Yeah.

VARLEY: Yes, a lot of it.

Q: Did you get any sleep at all?

VARLEY: I got some sleep but I've been through a phase of my life where I've spent quite a lot of time at the treasury one way or another and I've been seeing more of the chancellor and his officials than I have of my family. That was certainly true of that week.

Q: I can imagine it, it was. Did it feel like a sort of historic night?

VARLEY: I think in a sense it was too, it was too important for one to be reflecting very much on the historical significance of it but I think as we developed the solutions that became public the following day, and as further work went on later that week leading to the decisions that were taken by the tripartite authorities on the following weekend, it was very clear that something of sig, of

historical significance was occurring. And indeed I do regard it as historically significant. I think this crisis continues but it seems to me there are two big chapters to it. There is a, there is a banking crisis and there is now in a sense the more familiar, ugly but familiar issue of recession and economic slowdown.

I think the banking crisis is substantially contained. I think the worst of the banking crisis is behind us. I think what the world now has to grapple with is the difficult issue of rapid economic slowdown.

Q: And if I could just take you back just for a little bit longer to that week, so the framework is announced on the Wednesday morning. I know that a formal decision hadn't been taken by the treasury that they were definitely going to do in a sense the comprehensive solution the following weekend but were you yourself pretty clear that once you had the framework, you just had to get on with it and get, and get the rest of it agreed?

VARLEY: Well I mean to be clear, what was, what was agreed on the Tuesday night and announced on the Wednesday really related to the raising of capital for the technicians, tier 1 capital, across the UK banking system and you'll remember that an aggregate commitment was made by the big British banks, including Barclays, that we would together raise about twenty-five million pounds worth of tier 1 capital. What happened over the following weekend included other aspects of remediation. It was clear that it was in contemplation at the time and it was clear that time was of the essence and that something had to be done quickly, and, and when I look at what was achieved over the weekend of the 11th and 12th of October, a lot of ground was covered by the tripartite authorities. And I'm I'm, I'm pleased that we were able to get to the solutions that we got to within that absolutely critical forty-eight hours.

Q: I mean I suppose the thing which in a way slightly surprised me was you had the announcement on the Wednesday morning of a pretty comprehensive package and it was a pretty clear statement from the government that they were going to stand behind the banking system. And yet for the Royal Bank of Scotland and HBOS the funding problems persisted which is why in the end the authorities quite sensibly took the view you know speed was of the essence and you know you were all got in and you know you all had your separate negotiations about how much capital you were going to raise and in what form. I mean did – were you at all surprised that none, that that general statement didn't placate markets?

VARLEY: Well I think it was, it was symbolic of the gravity of the situation that actually the funding situation with certain banks in the market deteriorated notwithstanding that announcement. That's the point you're making, and it also became clear that what was required was something that was done across the waterfront. If I look at our own situation, we have throughout this crisis actually been

takers of deposits. We've been, we've been increasing the liquidity that's been placed at our disposal by depositors all around the world, and even during that week that remained true of Barclays, I am happy and thankful to be able to say, but what we were dealing with was not a bank-specific issue. We were dealing with something that was now threatening the market as a whole and hence the action that was taken.

Q: Now you took a principled decision that you would raise the capital from the commercial markets, from commercial sources rather than taking it from taxpayers. What was on your mind in deciding that was the way to go?

VARLEY: It was simply an economic judgment. The judgment that we took was that the return on capital that we'd be able to generate if we raised that, that money privately would be superior over time to the return that we could generate if we took government money, and it's borne of a very, a very simple observation. Barclays of today is a UK bank but it's more than a UK bank. If you look at where growth has come from for our shareholders in Barclays over the course of the last years, a lot of that growth has come from outside the United Kingdom. Now our UK business is hugely important to us. We serve millions of customers here. Our UK business will always be very important to us but if I look at the rates of growth that our shareholders have had in Barclays, a lot of that growth has come from outside the UK in the past and will in the future.

Now British taxpayers' money of necessity must command a UK agenda. If the government had been putting capital into Barclays then that incremental capital would have had to have served a predominantly UK agenda. A lot of our agenda is a non-UK agenda so it would have, it would have resulted in a very significant change of strategy. That's not what we had been promising to our shareholders so we felt confident about our ability to raise the capital elsewhere. I make these points about the UK agenda of the government not to criticise. I simply observe the fact that if they're deploying British taxpayers' money, then of course they have to ensure that that money serves their British agenda. [PHONE RINGING OVER END]

Q: If I could ask you to truncate that – I think what you're saying is that as an international bank, obviously your priority is to you know put your resources, put your investment in the place which best you think meets your criteria for generating a decent return and you felt that if you took money from British taxpayers, that would in a sense, the choice would be made for you. You'd have to devote your resources to the UK in a way that you wouldn't necessarily want to do. Is that right?

VARLEY: It was of course true that if, if we had taken UK taxpayers' money then that would dictate part of our overall global agenda. I say again that our, that our UK business is extremely important to us but a lot of our growth has come from outside the United Kingdom,

and taking British taxpayers' money would have changed the way in which we run Barclays and that seemed to me to be not the right thing for us to do. If I look at the Barclays of today, we have more customers outside the United Kingdom than inside the United Kingdom. We have more branches outside the United Kingdom than inside the United Kingdom. We employ more people outside the United Kingdom than inside the United Kingdom. Therefore the implications for Barclays of taking UK government money were I think more far-reaching than for some of our more domestically oriented competitors.

Q: Now as a bank you haven't suffered the calamitous problems that many of your competitors, both domestically and internationally, have experienced. But as an industry it hasn't covered itself in glory frankly in the recent period. Is there a way of capturing what the industry as a whole got wrong in the preceding few years?

VARLEY: Well I'll try. I mean I think that the, the genesis of the crisis was of course the sub-prime fall-out.

Q: That was a sort of trigger rather than –

VARLEY: I agree. I think it was, it was a catalyst but it wasn't the cause if I can describe it in that way. If you ask me what the cause was, I think it was a long period of the availability of easy money being made available by, by central banks around the world and that led to a massive increase in asset prices through time, and that led to a diminution in yield, and how could those who were reliant on yield offset the diminution by leverage? And so what you see as a common thread through the history of the markets over the course of the last five six seven years is a steady increase in leverage –

Q: Borrowing?

VARLEY: Yes whether that's borrowing by companies or whether it's borrowing by governments or whether it's borrowing by individuals like you and me. That is the common thread that runs through the, the history of the financial services industry over the course of the last years. Now I think there was a view, I mean looking, looking back on it it was clearly a misapprehension but there was a view that such was the diversification of risk as a result of the sophistication of markets, that we were in a new world where the world of the risk cycle if not been abolished, it had been significantly mitigated or subdued the risk cycle and that looking back on it was wrong. Did banks take too much risk? Yes. Were the governance systems across, across the banks looking back on it as an industry inadequate to manage that risk? Yes. But was there also a failure by, by governments and by regulators around the world who in a sense acquiesced in this extraordinary boom in asset prices? Yes. So I think there are a number of players who are responsible but do the banks stand out, should the banks be prepared to acknowledge their responsibility, to say sorry? Absolutely, we should as an industry. And there are two reasons for that.

One is it's appropriate because of the confusion that millions and millions of people, customers in the world, feel at what's happened, you know what has happened. They need somebody to take responsibility and I think it's important that the industry as a whole is prepared to do that. But there's another also very important point which is that a lot of effort over the course of the next twelve months will be directed at remediation, at trying to ensure that this cannot happen again and the banks must have a seat at that table, and they will only have a seat at that table if they are humble and contrite. The reason why they have to have a seat at the table is because risk taking is an important feature of economic growth in the world and the banks have to continue taking risk.

Q: In terms of –

I fear you may see this as a slightly fatuous question but I'll ask it anyway. In terms of where you would apportion responsibility on the analysis you just made about the excess of debt, do you think it is the fault of the borrowers who borrowed too much or do you think it's more the fault of the lenders who lent too much?

VARLEY: Well I think the answer isn't binary. It would be convenient were the answer binary. What is for sure is that banks made it very easy for people to borrow and banks made it easy for people to overborrow. Is there a primary responsibility in, in a borrower to make a wise and responsible decision about the ability of that borrower to, to repay and service a debt? Of course and we can never, we can never remove that responsibility. That's the whole principle of caveat emptor. It's an important part of all commercial life whether for individuals or whether for companies, but would it be wrong for me just to ascribe all of the responsibility to, to consumers around the world who geared up, who borrowed too much, similarly companies? I think it would be wrong for me to ascribe all responsibility. The banks made it too easy and the central banks and regulators made it too easy, and we should share our responsibility, our sense of responsibility for that.

Q: Earlier on today I was chatting actually to somebody who runs a big investment bank and I asked about how they got it wrong in terms of working out the risk of a lot of deals that they did and he then went into a long description of value risk models and the data and you know they worked, they stress tested everything and you know at the end of the day he had to put his hands up and say you know historic data was misleading, that it didn't go back far enough and you know they hadn't stress tested enough against you know thousand year cycles as opposed to twenty year cycles. I mean I emerged from this just thinking to myself actually is that, was that the right approach? I mean wasn't, didn't banks to a certain extent just get away from common sense. There were certain deals I remember in 2005 6 7 which just looked to me to be silly. And you know they just screamed at you, Northern Rock's 125% you know loans for mortgages looked mad. Lots of

the private equity lending just looked bonkers. Why do you think in a sense the, some of the lenders just forgot about common sense, forgot about basic principles of good lending?

VARLEY: I think there was an impression that the diversification of risk and the distribution of risk through securitisation, through the capital markets had had, would have in the future a significantly dampening effect on the possibility of systemic crisis, and the principles of good lending are, are as old as, as time. And it is absolutely clear that on something simple like loan to value ratio in a mortgage, people got it wrong. If you look at our parents' generation, our parents' generation would always have saved for the deposit for a house or for a flat. That was an absolutely basic instinct of wise household planning. But in a world of 100% loan to value ratios, or 125% loan to value ratios, there is no saving for a deposit, rather the reverse. The bank gives you some money as you go out and borrow, and I think you know to that extent we had abandoned, as an industry we had abandoned basic wisdom and there's no doubt that that is a significant contributor to what has happened here. I referred earlier to the subject of leverage. Whether it's companies, whether it's individuals, there was too much borrowing in the system and the, the agony that's occurred over the course of the last twelve months and there will be more pain I think in the months ahead, that is attributable to people reducing their borrowing and it's a very painful thing to do.

Q: So if we could just now look forward to the future, how long do you think this process of lending being, contracting – how long do you think the process of, of not just banks but other financial institutions contracting the amount of credit they either want or can provide is going to last for?

VARLEY: Well I, I think that we will see the process of, of reduced borrowing play out over at least the course of the next twelve months, maybe, maybe twenty-four months. I think it's important to say though that the industry is open for business. If I look at Barclays, I mean we're open for business. If I look at two areas that are of great interest to the media and to the government at the moment which is lending to small business and, and more, the provision of mortgages, if I look at our own lending balances in lending to small and medium enterprise businesses, those lending balance are up 7% year on year. We've recently announced a new initiative where we're saying that we're prepared to increase our commitment to that market, similarly in mortgages. We've very significantly increased our market share in mortgages over the course of the last twelve months so I think there is a point of view that that, that credit has stopped, that the supply of credit to the market is something that has been switched off, that's absolutely not –

Q: No no I wouldn't take that view but we all know that overall the amount of credit available globally and in the UK is shrinking.

VARLEY: Yes it's shrinking, it absolutely is. And that is a painful process, it's a process through which the world absolutely has to go and if you asked me when will it stop, I think it will stop when asset prices stabilise. As soon as asset prices stabilise, then we will see the financial economy start to recover and when will that occur? That will occur some time over the course of the next eighteen months.

Q: And do you think that the kind of pressure that the government is putting on the banks to allocate their lending to particular sectors, small businesses, home owners or those who want to buy a house – excuse me – do you think that that is sensible because plainly in a world of small, where capital is more scarce than it was, where there is less available to lend, if the government says banks have to lend to these sectors, there is going to be less available elsewhere.

VARLEY: Yes if I start with the point of first principle though, risk-taking by the banks is designed to help risk-taking by consumers or by companies. It might be the risk of, of taking a loan for university education or the risk of taking a loan for a first flat, or the risk of taking a loan for a business start-up. That is risk-taking by consumers which is facilitated by the banks. And is that risk-taking made easier in circumstances of a low interest rate environment? Absolutely it is. So if you ask me do I feel that central banks around the world have made good judgments in reducing interest rates to try to pump prime economic growth, I absolutely do think that but that needs to be a short burst. What we can't have is perennially low interest rates. Perennially low interest rates have led to the spike in asset prices that we've been discussing in this conversation and that is a fundamental driver of the crisis that we have experienced. So what I would say is do I understand why this government and governments elsewhere in the world are encouraging the banks to take risk and to lend? Absolutely I do and it's right that they should. What they shouldn't do is tell the banks how to price that risk. The banks have to make their own decisions about risk pricing.

Q: But I was also, I mean I think that's a very interesting point but I was also asking about the way they're telling you that you've got to lend to small businesses as opposed to other kinds of businesses for example.

VARLEY: Well small businesses are a very very important part of, of economic growth. If you think about the, the dynamism of the British economy, a lot of that is based on the, the risk-taking by small business owners and for us at Barclays it's always been a hugely important part of our business. We have a big market share in our business and as I said earlier in our conversation, we are absolutely open for business to those business customers so I can understand why risk taking by business broadly described is regarded by government as an absolutely critical ingredient of economic growth and stabilisation. The example, the historical example I would give you over the course of the last twenty years

or so would be in Japan because in Japan in the early 1990s as you will remember, the banks for a series of reasons lost their appetite to lend and they hunkered down and they withdrew, and the consequences for the Japanese economy were very dire indeed, ten years of basic economic stagnation. So it is extremely important that banks having the ability to price for the risk as they see it, see, see fit, are out there in the market lending and that's certainly the attitude of Barclays.

Q: Now one of the most extraordinary phenomena that we witnessed, and I certainly never thought I'd see this, is that if you look across the world now and you put together the various schemes in place from America to the UK to France to Germany to South Korea to Australia, well the latest sum that I did was that something like thirteen and a half trillion dollars of taxpayers' money is being provided in the form of loans, guarantees, commitments, investment in banks, I mean support for the banking system. It's an astonishing sum, it's about a sixth, it's about a fifth – sorry, no it's about a quarter, a quarter of global GDP, of global economic output, an astonishing sum of money and it's rising. It's rising here, it's rising in the States. What do you think the implications for the banks are of that degree of taxpayer support?

VARLEY: Well to be clear this is a means to an end. I think it's very important that we understand the context of this. The support that you're referring to is not an end in itself. The end is economic stability and economic growth. Governments around the world are not supporting the banks in the way that you've described to help the banks. They're not, they're not there as philanthropists. They're there to ensure that their citizens flourish through economic stability and economic growth. That's the first thing to say. Are we likely as a result of the support that you refer to around the world, are we likely as a result of the crisis that's occurred to see a lot of regulation and a lot of legislation in the financial services industry, to try to safeguard the system from this sort of crisis in the future? I mean it seems to me that that is inevitable but I, I urge the governments around the world and I urge supervisors around the world to make sure that they aim at the right target, and the thing that would be catastrophic as I would see it for global economic growth over the course of the coming years would be if steps of remediation were taken that in some sense inhibit excessively risk taking by banks because risk taking by banks lies right at the heart of the ability of an economy to grow.

Q: But when banks in general are so dependent on the goodwill of taxpayers, will banks' behaviour change?

VARLEY: Well I mean I think that you, you should distinguish between those banks where there is taxpayers' money on the share register, and that will create one set of behaviours I think and understandably so, and then there is the broader issue of support given by governments to the sector and I think that that will create a different set of behaviours. Is it, is it likely that banks over the

course of the coming years will be more risk averse? Yes. Are there, are there credit extension criteria likely, are there lending criteria in other words likely to be more conservative? I think that is inevitable. But I see that really as a consequence of the crisis and the issues for risk management that that has posed rather than the intervention of government.

Q: But do you think that you're all going to have to just be a little bit more sensitive to how you're perceived?

VARLEY: Of course, of course. You know this is a, this is a public relations crisis for the banking industry. You have to have an industry, a banking industry in which consumers have trust and in some cases that trust has broken down. Now if, if I ask myself do I feel that the industry should be self-confident about recreating that trust through time, I do feel that but it starts by saying sorry. It starts by admitting that things went wrong, not everywhere. I mean there are plenty of banks in the world in whom – and I hope Barclays is one of them in whom - customers have trust but if you look at the industry as a whole, if I speak as a member of the industry rather than as chief executive of Barclays, I absolutely have to say we should share our, our portion of responsibility. We have to recreate trust and I say that not just because I'm, I'm a selfish banker. I say it because I think it matters. If the world is going to grow at four percent economic growth over the course of the next decade, which is what the world needs to do, then risk taking by the banks and the successful operation of liquid trusted capital markets is, is an indispensable component of that recovery.

Q: Now one of the things that lots of people have contacted me about, particularly those who are slightly older and have savings, is – I mean they feel a bit sore about the cut in interest rates. I mean there's a generation of, of slightly older people who have paid off their debts, who feel that they've behaved prudently and they feel that this cut in interest rates is punishing them. They feel that they're being punished for their prudence in order to bail out people they - and institutions, companies and people that they feel were feckless. I mean do you think that's, I mean do you understand why certain kinds of people feel very angry that as I say they've been prudent but they appear to be being punished to bail out those who you know behaved recklessly?

VARLEY: Of course I understand that. And indeed I have lots of communications with our customers who say just those things to me. I do understand it. It is important that the world takes advantage of a period of low interest rates to try to pump prime the economies in the way that we have been describing but if I look at, if I look at the world in the round, do savers exceed in numbers borrowers? Absolutely they do, and this is, it's a moment of, of particular difficulty for millions and millions of savers around the world. Do I feel that we should nonetheless be confident about the ability of government to understand that? Are we going to go through a period over the course of the next ten

years where governments around the world are conspiring to encourage saving? Are we going to see an increase in savings rates around the world over the next ten years? All of those things I think are true and you can point to some great features of the, or examples of the democratisation of saving. I think the United States, it's something that it's done very well, the 401K programme which has brought basic savings and investment to millions and millions of American households and I think we will see in this government and in governments elsewhere around the world, we will see a lot of effort directed over the course of the coming years at encouraging people to save and that's a very very important part I think of the development of the industry and the development of the economies.

Q: I mean if you think back to that extraordinary weekend, I mean again did you get any sleep on the sort of Saturday, I mean because – the chancellor told me that on the Sunday he – was negotiating with all of you and then I think he said that something like midnight or something there was a detail to do with the operation of one bit of the package that the banks had asked him to go back on and he just thought oh well I'm going to leave that to others to sort out and – he didn't quite say bugger it but he came quite close and so off he went to bed at one o'clock assuming that when he got up at five it would be fixed, and it was. Did you, I mean did you manage to go to bed that night or –

VARLEY: I did go to bed on the Sunday night but if you ask me did I get, did I get enough sleep over that weekend the answer is no. I mean it was, it was a very very busy weekend. But I sat here in Canary Wharf surrounded by my team and we worked away at it, and we –

Q: Were you shuttling back and forth to the treasury from here?

VARLEY: No no no. I was –

Q: You didn't go to the treasury yourself that weekend?

VARLEY: I did not go, I know it's been reported that I went down on bended knee to make some pleas with the government but I did not do that. I sat here in the building surrounded by my team and the contact – we had, the Financial Services Authority visited us many times over the weekend.

Q: So Hector Sants had been to see you?

VARLEY: And there was a lot, there was a lot of telephone contact with the other members of the tripartite authorities but it seemed to me the right place to be to, to deal with this was here where we could be close to our board, and where I could have my team around me and very well served I was by them that weekend.

Q: So was it your investment bankers who would have gone to the treasury then to talk to them?

- VARLEY: No we were here.
- Q: You just did it all by phone? Oh I see.
- VARLEY: We were here.
- Q: OK OK and so – was there a sort of, a moment where, of either sort of exasperation or euphoria? Can you remember any particular key –
- VARLEY: No I think it was, actually considering the, considering what was at stake, considering what the Financial Services Authority was seeking to engineer on behalf of the tripartite authorities over that weekend, I think that the spirit of the discussions and indeed the outturn of the discussions was extremely constructive. Were they tense from time to time? Did it feel as though there were some very important judgments to be made by the board here? Did it feel as though we had to make continuous good decisions during the course of the weekend and make sure that we were keeping the appropriate people informed of that? Yes, I mean it was – the stakes were high. But was it, did I feel that, was my mood gyrating and did I feel that we were out of control? I didn't feel those things. I think we were I hope appropriately calm so that we could make rational judgments and I believe we did make rational judgments that weekend.
- Q: And was there ever a moment where you thought that the treasury had got it wrong?
- VARLEY: No because the treasury offered us choice. I mean the treasury, the treasury's ambition was simply to ensure that the banks raised capital and we agreed with the Financial Services Authority acting on behalf of the tripartite authorities how much we were going to raise and we were given a choice about, about how to raise it and indeed over what time to raise it. We were given until the summer of 2000, 2009 to raise it.
- Q: Now there were just a couple of other longer term questions that I wanted to really ask you about. One was – there's an analysis by the Bank of England about one source of pressure on the British banks which was the growing reliance from 2000 onwards on wholesale funding, and as you know there's the analysis they've made that the net dependence of British banks on wholesale funding was nil in 2001 rising to £740 billion in the middle of this year, and a lot of the money that taxpayers have provided in the form of loans and guarantees has gone into in a sense replace that wholesale money which is very difficult now to obtain. Do you yourself think that we have seen a permanent reduction?
- VARLEY: No I don't.
- Q: In the net availability of money of that sort or –

VARLEY: No.

Q: Right.

VARLEY: And it's very important that, that that, that pushback that I give you is substantiated because here's why, Robert. There isn't enough, if I can describe it this way, onbalance sheet lending that banks can do, in other words conventional lending. There isn't enough of that in the world to allow the world to grow.

Q: Right.

VARLEY: So the capital markets in the form of bond issuance, in the form of securitisation have to play and will play - I feel confident about it – a vital role in the development of the world economy over the course of the coming years.

Q: Could I just unpick that for a second? So you're saying...So to be clear about that, I view the growth in wholesale lending, in the lending that comes from sources other than your UK based customers for example, as a reflection of the recycling of surpluses generated in for example great exporting countries like China and the Middle East and Japan. Are you saying that you think it's incredibly important that that process of recycling those surpluses all over the world frankly in the form of of of loans has to continue, has to be revived?

VARLEY: Yes I absolutely am saying that and the reason is this, that, that if you think about what companies around the world are seeking to do, and they're seeking to, they are issuers so they're borrowing either through conventional borrowing or by issuing bonds in the market, and they're managing risk. And I would put it to you that the capital markets are indispensable in helping companies who employ, who generate tax, in helping companies manage risk and issue debt and a world where the capital markets cannot contribute to that process is a world that will not grow. It's as stark as that.

So if you look at, if you look at the world of bond issuance today again there is a sort of, there is a conventional wisdom in some parts of the media in any event if I can put it that way, that bond issuance has stopped. Bond issuance hasn't stopped. There's a view that securitisation, that the funding of securitisation vehicles has come to an end. It hasn't at all. What is clear is that these vehicles, these instruments have got to be transparent. One of, one of the reasons for the breakdown in confidence that we've seen in the course of the last twelve months is that some of these instruments became increasingly opaque. Cash flows were not understandable. Now will investors want to invest in such instruments going forward? Of course they won't. But let's put it another way. Do investors, for example investors who manage pension funds on behalf of millions and millions of citizens of the world in retirement, do they need yield? Will they have to invest to create yield? Will they need to invest in bonds that generate

yield? All of those things are completely unchanged. So if you think about the democratisation of welfare provision, and all that stands behind that, it's a very important component of an ageing world that pension funds can drive yield and find yield and deliver yield on behalf of their beneficiaries. That's a big source of growth in the capital markets. That is completely unchanged notwithstanding everything that's happened.

Q: Except that that money at the moment is going into government debt. You're right that – I'm not, I would not ever say that you know all the capital markets have closed down but there are increasing difficulties –

VARLEY: A lot of them, I agree.

Q: A lot of it, a lot of it is not functioning properly and a huge amount of cash is going into you know, you know US government bonds, US government bonds, UK government bonds and not directly to companies for example who, who can use it productively to create wealth. I mean that is a problem isn't it?

VARLEY: If we were making a generalisation of the last twelve months, one of the consequences of the breakdown in confidence has been that a lot of that money – and there is an enormous amount of it in the air waiting to land – a lot of that money has gone into government bonds in the way that you described, with an uptake in confidence and I believe that there is an uptake in confidence. I don't want to overstate that but I see it. I see some of that money going into the sort of outlets that we've just been talking about. There is, there is a small but detectable improvement in confidence in the money markets as an example. All of this is about confidence but, but I go back to the point about yield. Do pension funds around the world need yield to support their beneficiaries in retirement? They do and it's the obligation of the banks, it's the obligation of the central banks to create an environment in which people can have confidence as they pursue that yield. That is the work that has to commence now and get done quickly and safely.

Q: And what would in your view, is there anything that can be done to speed up the revival of you know what you would see as an absolutely vital component of modern capitalism?

VARLEY: Well I wish there were, I wish there were a single silver bullet and I don't believe there is but I think that what has been done by governments around the world to foster the regeneration of confidence, to support the financial services system, in pursuit of economic growth, I think those are, those are very necessary steps and collectively they will have an impact. Without doubt collectively they will have an impact and are having an impact.

Q: But you're an optimist, you think that these markets will revive?

- VARLEY: I hope I'm a realist. I'm realistic about the fact that 2009 is going to be a difficult year for the world but I would be surprised, seeing how much stimulus has been put into the economies around the world over the course of the last twelve months, I would be surprised if by the end of next year, the end of 2009, we are not seeing the green shoots of recovery, in markets in any event.
- Q: And by that you mean that those individuals and institutions that control vast amounts of cash, will be lending them directly to for example companies again?
- VARLEY: I am not suggesting that we will see a restitution of the, of the status quo as it was in 2006 and 2005. That will take longer, but will we start to see some of that money put to work in the areas that we've just been discussing? I feel, I think it's very likely that that will be happening before the end of 2009.
- Q: And then finally if you just think forward five years or so, how do you think the banking world, the financial world that you've lived and breathed for your entire career, how will that be different from how it was –
- VARLEY: Yes I think it will be different.
- Q: How will it be different? Characterise –
- VARLEY: Let me try. I would say two things principally. One is that extreme business models have been tested over the course of the last twelve months, and the extreme business models have failed, so if you look at mortgage lending which has been dependent on wholesale funding, that business model has failed. If you look at bulge bracket investment banking dependent on wholesale funding, that model has failed. The model that has, has proved resilient over the course of the last twelve months is the model of universal banking and I do believe that although we talk about the financial services industry as a global financial services industry, it's not global in the way that most industries are global. You know most global industries, the top dozen or so players, would have fifty or sixty percent of the turnover in the world. I'm talking about pharmaceuticals or oils would be two good examples. But in the financial services industry, only about twenty percent is in the hands of the top twelve or fifteen or so players. Now that will change, and it will change not as a result of mergers and acquisitions activity. It will change because of the convergence of customers' behaviour and need around the world, and I see that at work as we speak, and that is a big source of growth for the industry, and I do believe that, that banks that have the skillset and the footprint can and will successfully compete for business outside the United Kingdom, that's exactly what - outside their home market, in our case the United Kingdom. That's exactly what Barclays has been trying to do and if I just illustrate it with a specific, I mean if I look at the buying behaviours and needs of one of our credit card customers in India, those buying behaviours and needs are more similar than dissimilar to what I see to our

credit card customers in the United Kingdom. Can Barclays with its brand serve those customers in India? Yes we're doing so today. Is there a big opportunity I think for those banks who have the capability and the footprint and the brand that's trusted to take market share around the world over the course of the next five ten years? I strongly believe that, and that, that opportunity interestingly has been amplified as a result of the developments of the last twelve months because the competitive landscape has changed so significantly in the financial services industry over the course of the last twelve months.

Q: So paradoxically, although you know a number of very big institutions – UBS, Citigroup - stand out, have done spectacularly badly over the past year or so, you think actually we may be moving into a world where a handful of banks will be even bigger, will have a bigger share of the market?

VARLEY: Well believe me, I am realistic. We have our feet on the ground, we have to manage risk day in day out, we have to ensure that we're there to support customers day in day out. But as we manage those risks, as we create that support, let us not lose sight of opportunity in the world because although this crisis has created an environment harder than anything that I've seen in my professional life, it has similarly created opportunities greater than anything that I've seen in my professional life and as we pursue those, we need to be realistic but we mustn't lose sight of them. I do think that for self-confident and strong banks, the opportunity of the next five years is considerable.

Q: John Varley, many thanks!

VARLEY: Thank you very much.