NOVA SCHOOL OF BUSINESS & ECONOMICS

Barclays Bank, 2008

Group 14

Ana Anastácio	51761
Beatriz Mendes	51920
Rodrigo Sereno	51676
Michel Macedo	65691
Charlotte Hentschel	66169

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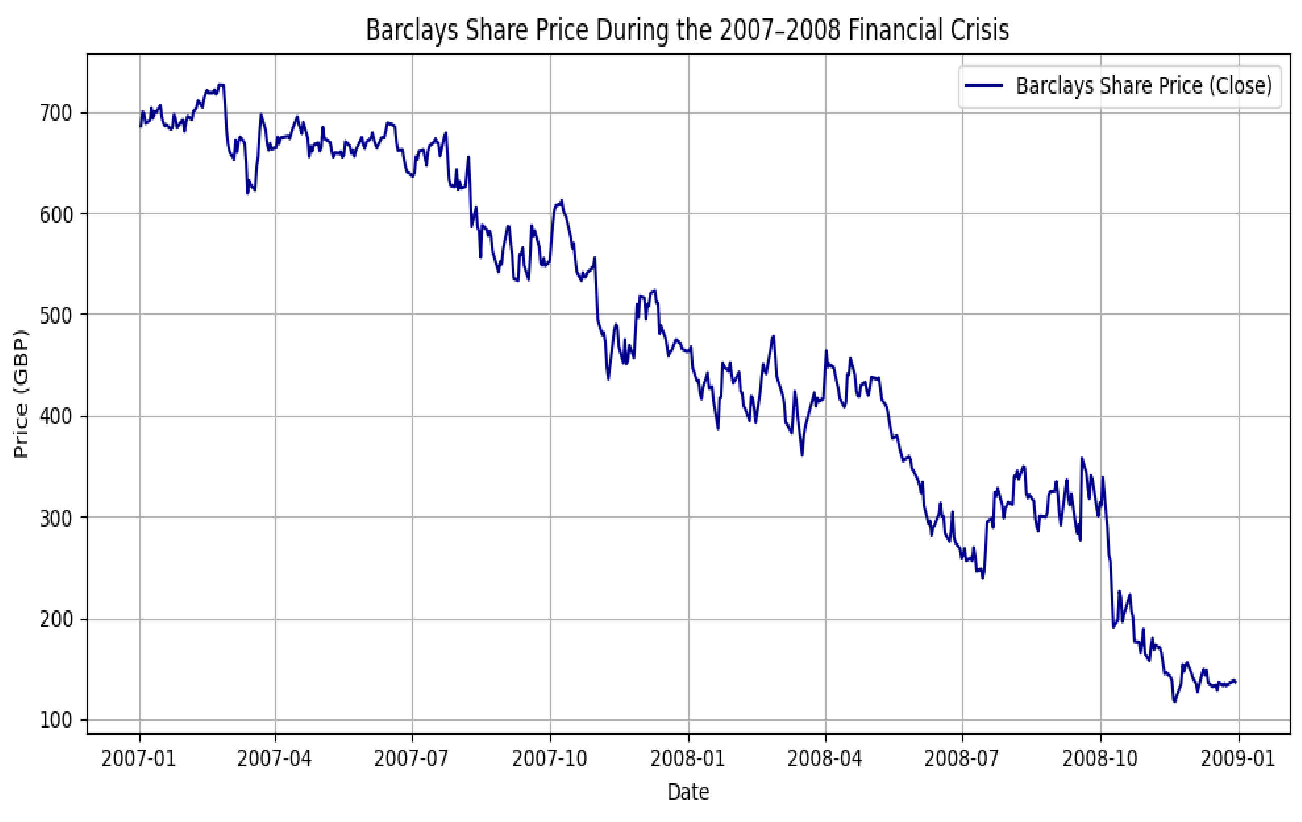
Barclays Bank in the 2008 Financial Crisis

How Did Barclays Perform in 2008?



How Did Barclays Perform in 2008?

Share price down >50% from 2007 peak

£2.8B asset write-downs by mid-2008

Still profitable, but confidence eroding rapidly

Liquidity pressure: interbank lending froze

Urgent Capital Requirements

Why?

- **Regulatory Pressure:** UK regulators unexpectedly raised the required Tier 1 capital ratio to 9% to strengthen the banking system amid the global financial crisis.
- **Financial Stress:** Declining share price, liquidity constraints
- **Avoid Government Intervention:** Barclays wanted to avoid accepting UK Government bailout funds, which would impose restrictions on dividends, bonuses, governance, and scrutinize sensitive business areas like its Structured Capital Markets (SCM) unit.

How Much? At What Cost?

- **£6.5–7 billion** by mid-2009 to meet the new capital requirements.
- **Very high cost of capital** (due to market turmoil).
- **Shareholder dilution** at very low share prices.
- Risk of not finding enough willing investors quickly
- Raising equity during panic could signal weakness and further harm confidence.

Other Issues

- **Systemic Risk:** The UK government was acting to prevent a collapse of the entire financial system.
- **Market Confidence:** Restoring trust in banks was crucial to stabilize the economy and resume normal lending activity.
- **Political Scrutiny**: Accepting public money meant surrendering some corporate control to political objectives (e.g., forced lending targets, bonus restrictions, governance changes).
- **Sovereign Investment Risks:** Barclays' alternative (private Middle Eastern funding) raised concerns about reliance on sovereign investors with potential future conflicts.

Barclays navigating financial turmoil in June 2008

Need of immediate capital to increase capital ratios due to the beginning of the **financial crisis**

Ways to **increase capital ratios**:

- Increase commom equity ✓
- Decrease regulatory asset base (risk weighted assets) ✗

Issuance of pure equity was possible, thus the company raised capital through a **rights issue**.

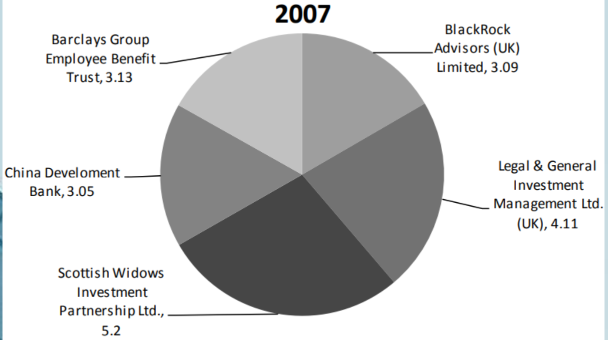
"The UK Companies Act 2006 provides existing shareholders in UK companies with a right of pre-emption – that is, a right to buy shares, on a pro-rata basis and within a specified period, on the same terms as they are issued to any other individual or institution."

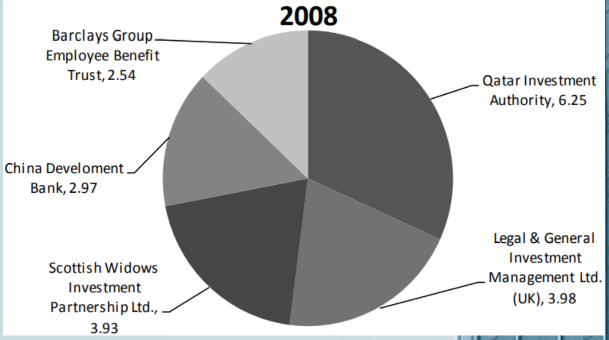
However, the rights issue was not that successful because

- **Only 19%** of the 1.6 billion shares were sold to existing shareholders at 292 pence

Solution: sell remaining shares to sovereign wealth funds and other institutional investors at 282 pence (on average, at discount)

New structure of Barclays' shareholders





Source: Exhibit 6

Winners of the transaction:

- **Barclays**: this capital injection raised £4.5 billion and increased the Core Tier 1 and Tier 1 capital ratios (from 5% to 7% and from 7.3% to 7.9%, respectively), showing internal strength instead of desesperation
- **QIA**: by investing £2.3 billion became the largest shareholder
- **Other investors**: share price increased after the transaction

Losers of the transaction:

- **Existing shareholders**: dilution of the share price of the shareholders that did not in the rights issue

In conclusion, the transactions were a **great idea** in order to **increase capital immediately**, given the circumstances

Pure equity is not an option in October 2008

Investors' behavior
Barclays' investors were scared due to the financial crisis and the declining share price of the bank.
Furthermore, Barclays pre-marketed a possible equity offer to the largest shareholders and the response was not positive as the bank needed.
Additionally, since September 2008, investors were worried that the bank was underestimating the magnitude of the risk of its assets (with some of Lehman Brothers' assets).

Avoid desperation and stigma
By going to shareholders multiple times in a short period (June 2008 and September 2008), can be seen as a distress move, which makes investors skeptical.

Need of long-term capital and impact on share price due to investors' confidence
By issuing pure equity, the market could bring speculative investors to the company, which would not be an objective of the bank.
Moreover, the issuance of the shares would require a very significant discount on the share price, consequently reducing even more the share price, impacting also the depositors' confidence.

BBC report's impact
After the BBC's report announcing that Barclays was to accept UK Government ownership, *"the consequences of failing to raise money from the market might be very severe"*.

Potential Government Offer – Advantages and Disadvantages

Government Offer

£3 billion in Preference Shares
- 12% fixed annual dividend until 2013, then LIBOR + 7%
- Non-convertible, non-voting, redeemable by Barclays

£4 billion in Ordinary Shares
- Issued at ~8% discount to market price
- Issued to the public but underwritten by the government

Fees
- **2%** on preference shares, **0.5%** on ordinary shares

Additional Conditions:
- **Dividend ban** for common shareholders until preference shares are repaid
- **Bonus** restrictions for top management
- **Governance changes:** new independent directors appointed
- **Lending requirements:** mortgage and SME lending restored to 2007 levels
- **State aid compliance**: subject to EU restrictions and restructuring plans

Advantages

- Fast and guaranteed £7B capital injection
- Tier 1 ratio raised above 11%, meeting regulatory targets
- Government backing could stabilize markets and share price
- Lower transaction costs (~£80M vs. £300M private deal)
- Consistent terms with RBS/Lloyds; supports regulatory alignment
- Opportunity to be seen as contributing to national financial stability

Disadvantages

- Dividend payments to shareholders restricted
- Executive pay limits and bonus bans; may impact talent retention
- Government-appointed board members reduce management independence
- Lending targets tied to 2007 levels; limits flexibility in risk management
- Regulatory and EU state aid compliance increases reporting burden
- Potential scrutiny of Barclays' Structured Capital Markets (SCM) division

Middle Eastern Offer – Advantages and Disadvantages

Middle Eastern Offer

£3 billion in Reserve Capital Instruments (RCI)

- The interest on RCI's is tax deductible
- 14% annual coupon
- £1.5 billion warrants

£4.3 billion in Mandatory Convertible Notes (MCN)

- 9.75% annual coupon
- Convert into ordinary shares on June 30, 2009 (9 months after the issuance)
- £2.8B to Qatari investors and £1.5B to existing institutional investors

Fees

- Pay 2% commission on RCI's
- Pay 4% commission on MCN's

Additional Conditions

- There is a dilution protection agreement
- Barclays can not issue Tier 1 capital more senior than the issued to Qataris

Advantages

- Tax advantages through tax-deductible interests
- Remained independent from government control
- No restrictions on company management

Disadvantages

- Very expensive compared to the government offer (£300M vs £80M)
- Qatari investors can reach an advantageous position in the company
- Existing shareholders may be unsatisfied with the privileges conceded to Qatari investors
- Warrants and MCN's cause dilution
- Dilution protection clauses might discourage future and existing investors

The Middle Eastern Offer is the Better Choice!

Independence

- Government investment would come with **heavy strings attached**: restrictions on **dividend payments**, executive **bonuses**, **lending mandates**, and influence over **governance**. These would reduce Barclays' **ability** to act **independently** and competitively, especially in **global markets**.

Government Bailout

- Unlike RBS and Lloyds, Barclays still maintained **market access**. A bailout might **signal weakness**, damaging market confidence and shareholder **value**. The private route demonstrates **strength** and **resilience**.

Commercial Potential

- A deeper partnership with Middle Eastern **sovereign wealth funds** could open new business **opportunities** in rapidly **growing regions**. This is not just capital, as it's a gateway to **strategic global growth**.

Shareholders Interest

- The private deal avoids **political interference** and aligns better with our fiduciary duty to **maximize** long-term **shareholder value**. Government ownership would prioritize **public policy goals** that may not align with **investor returns**. Additionally, this deal **minimizes dilution** comparing with the **bailout**.

Swift Execution

- **Time** is of the essence. The Middle Eastern deal allows us to meet **capital ratio** requirements **quickly** and on terms already negotiated. There's **no certainty** that **government terms** won't worsen in future negotiations.